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1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accompanying financial statements of the Commonwealth of Massachusetts (the Commonwealth) have been prepared in accordance with accounting principles generally accepted in the United States of America, (GAAP). The Governmental Accounting Standards Board (GASB) is the recognized standard-setting body for establishing governmental accounting and financial reporting principles. The significant Commonwealth accounting policies are described below.

A. Reporting Entity

The Commonwealth is comprised of three branches: the Executive Branch, with the Governor as the chief executive officer; the Legislative Branch, consisting of a Senate of 40 members and a House of Representatives of 160 members; and the Judicial Branch made up of the Supreme Judicial Court, the Appeals Court and the Trial Court. In addition, the Legislature has established 56 independent authorities and agencies. Below the level of state government are county governments and 351 cities and towns exercising the functions of local governments. The cities and towns of the Commonwealth are also organized into 14 counties, but county government has been abolished in seven of those counties in recent years.

For financial reporting purposes, the Commonwealth has included all funds, organizations, account groups, agencies, boards, commissions and institutions. The Commonwealth has also considered all potential component units for which it is financially accountable as well as other organizations for which the nature and significance of their relationship with the Commonwealth is such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. As required by GAAP, these financial statements present the Commonwealth of Massachusetts (the primary government) and its component units. The Commonwealth has included 35 entities as component units in the reporting entity because of the significance of their operational and/or financial relationships with the Commonwealth.

Component Units and Details of Departments and Funds that are Separately Audited

Blended Component Units, Departments and Funds that are Separately Audited – Blended component units are entities that are legally separate from the Commonwealth, but are so related to the Commonwealth, that they are, in substance, the same as the Commonwealth or entities providing services entirely or almost entirely to the Commonwealth. The net assets and results of operations of the following entities are presented as part of the Commonwealth's fiduciary fund type operations:

- **The Pension Reserves Investment Trust Fund, (PRIT)** is the investment portfolio for the pension net assets of the Commonwealth and as such, is presented as a blended component unit. PRIT is managed by the Pension Reserves Investment Management (PRIM) Board.
- **The Massachusetts Municipal Depository Trust, (MMDT)** is an investment pool of the Commonwealth and its political subdivisions. A firm other than Deloitte & Touche, LLP, audited PRIT and MMDT.

The following departments are separately audited from the Commonwealth but are not legally separate from the Commonwealth:

- **The Massachusetts State Lottery Commission** runs the Commonwealth's lottery. The net assets of the Commission and results of operations are presented as part of the Commonwealth's governmental activities. A firm other than Deloitte & Touche, LLP, audited the Commission.

The Institutions of Higher Education of the Commonwealth has operations and net assets that are presented as part of the Commonwealth's business – type activities. These systems include:

- **The University of Massachusetts System** including its discretely presented component units, the University of Massachusetts Building Authority, the University of Massachusetts Foundation, Inc., the Worcester City Campus Corporation (doing business as Umass Health System.) The Worcester City Campus Corporation includes a not-for-profit subsidiary, the Worcester Foundation for Biomedical Research, Inc. Finally, the University System includes the University of Massachusetts Dartmouth Foundation, Inc.
- **The State and Community College System** includes 9 State and 15 Community Colleges located throughout the Commonwealth. The following are Community Colleges:
 - Berkshire Community College
 - Bunker Hill Community College
 - Bristol Community College
 - Cape Cod Community College
 - Greenfield Community College
 - Holyoke Community College
 - Massasoit Community College
 - Massachusetts Bay Community College
 - Middlesex Community College
 - Mount Wachusett Community College
 - Northern Essex Community College
 - North Shore Community College
 - Quinsigamond Community College
 - Roxbury Community College
 - Springfield Technical Community College

The following are State Colleges:

- Bridgewater State College
- Fitchburg State College
- Framingham State College
- Massachusetts College of Art
- Massachusetts Maritime Academy
- Massachusetts College of Liberal Arts
- Salem State College
- Worcester State College
- Westfield State College

Within the State and Community College system is a blended component unit, **The Massachusetts State College Building Authority.**

All Institutions of Higher Education are audited by a firm other than Deloitte & Touche, LLP. One institution, did not have an audit performed.

Discretely Presented Component Units that are Separately Audited – Discrete component units are entities which are legally separate, but are financial accountable to the Commonwealth, or whose relationships with the Commonwealth are such that exclusion would cause the Commonwealth's financial statements to be misleading or incomplete. The Component Units column of the combined financial statements include the financial data of the following entities:

Major Component Unit Authorities:

- **The Massachusetts Bay Transportation Authority, (MBTA)** provides mass transit facilities within the Greater Boston metropolitan area, comprising 78 cities and towns.
- **The Massachusetts Turnpike Authority, (MTA)** operates the Massachusetts Turnpike and the Boston harbor tunnel crossings that are part of the Metropolitan Highway System.
- **The Massachusetts Water Pollution Abatement Trust, (MWPAT)** provides a combination of federal and Commonwealth funds for water and sewer projects around the Commonwealth as operator of the Commonwealth's state revolving fund.

Minor Component Unit Authorities

- **The Massachusetts Convention Center Authority (MCCA)**
- **The Massachusetts Development Finance Agency (MassDevelopment)**
- **The Massachusetts Technology Park Corporation (MTPC)**
- **The Massachusetts Community Development Finance Corporation (MCDFC)**
- **Commonwealth Corporation (CBWL)** (the Corporation for Business, Work and Learning)
- **The Massachusetts International Trade Council, Inc (MITC)**
- **The Community Economic Development Assistance Corporation (CEDAC)**
- **Massachusetts Interaction (MAI)** (formerly Massachusetts Corporation for Educational Telecommunications)
- **The Massachusetts Housing Partnership (MHP)**
- **Route 3 North Transportation Improvements Association (R3N)**
- **The Commonwealth Zoological Corporation** (doing business as Zoo New England)
- **The Regional Transit Authorities (15 separate entities)** including:
 - Berkshire Regional Transit Authority
 - Brockton Area Transit Authority
 - Cape Ann Transit Authority
 - Cape Cod Regional Transit Authority
 - Franklin Regional Transit Authority
 - Greater Attleboro / Taunton Regional Authority
 - Greenfield-Montague Transportation Area
 - Lowell Regional Transit Authority
 - Martha's Vineyard Transit Authority
 - Merrimack Valley Regional Transit Authority
 - Montachusett Regional Transit Authority
 - Nantucket Regional Transit Authority
 - Pioneer Valley Regional Transit Authority
 - Southeastern Regional Transit Authority
 - Worcester Regional Transit Authority

Of the Component Unit Authorities, all except for MAI and MTPC were audited by a firm other than Deloitte & Touche, LLP.

Related Organizations

The following are “related organizations” under GASB Statement No. 14, “*The Financial Reporting Entity*”: Massachusetts Port Authority, Massachusetts Housing Finance Agency, Massachusetts Health and Educational Facilities Authority and Massachusetts Technology Development Corporation. The Commonwealth is responsible for appointing a voting majority of the members of each entity’s board, but the Commonwealth’s accountability does not extend beyond the appointments.

Availability of Financial Statements

The Commonwealth’s Component Units, Departments and Funds that are separately audited issue their own financial statements. These statements may be obtained by directly contacting the various entities. To obtain their phone numbers, you may contact the Office of the State Comptroller, Financial Reporting and Analysis Bureau, at (617)-973-2660.

Operating vs. Non-Operating Classifications of Primary Funds and the Business Type Activity

Revenues and expenses of proprietary funds are classified as operating or nonoperating and are subclassified by object. Operating revenues and expenses generally result from providing services and producing and delivering goods. All other revenues and expenses are reported as nonoperating.

B. Government – Wide and Fund Financial Statements

The Statement of Net Assets and the Statement of Activities report information on all non-fiduciary activities of the primary government, (the Commonwealth,) and its component units. Primary government activities are distinguished between governmental and business-type activities. Governmental activities generally are financed through taxes, intergovernmental revenues and other non-exchange revenues. Business-type activities are financed in whole or in part by fees charged to external parties for goods or services.

The **Statement of Net Assets** presents the reporting entity’s non-fiduciary assets and liabilities, with the difference reported as net assets. Net assets are reported in three categories:

- **Invested in capital assets, net of related debt** consists of capital assets, net of accumulated depreciation and reduced by outstanding balances for bonds, notes and other debt that are attributed to the acquisition, construction or improvement of those assets.
- **Restricted net assets** result when constraints placed on net asset use are either externally imposed by creditors, grantors, contributors, and the like, or imposed by law through enabling legislation.
- **Unrestricted net assets** consist of net assets, which do not meet the definition of the two preceding categories. Unrestricted net assets often are designated, to indicate that management does not consider them to be available for general operations. They often have resources that are imposed by management, but can be removed or modified.

The **Statement of Activities** demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues include (1) charges to customers or applicants who purchase, use, or directly benefit from goods, services, or privileges that are restricted to meeting the operational or capital requirements of a particular function. Taxes and other items not meeting the definition of program revenues are instead reported as general revenue.

Fund Financial Statements –

Separate financial statements are provided for governmental funds, proprietary funds, and fiduciary funds, even though the latter are excluded from the government-wide statements. Major individual governmental funds and major individual proprietary funds are reported as separate columns in the fund financial statements, with non-major funds being combined into a single column.

The Commonwealth reports its financial position and results of operations in funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures/expenses. Transactions between funds within a fund type, if any, have not been eliminated.

C. Measurement Focus, Basis of Accounting and Financial Statements Presentation

The government-wide statements are reported using the economic resources management focus and the accrual basis of accounting, as are the proprietary and fiduciary fund financial statements. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements imposed by the provider have been met.

As allowed by GASB statement No. 20, Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting, the Commonwealth's proprietary funds follow all GASB pronouncements and those Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins that were issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

The Commonwealth has established the following fund categories (further divided by fund types), and account groups:

Governmental Funds – account for the general governmental activities of the Commonwealth. Governmental fund statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recognized as they become *susceptible to accrual*; generally when they are both measurable and available. Revenues are considered to be available when they are collected within the current period or soon enough thereafter to pay liabilities of the current period. Significant revenues susceptible to accrual include income, sales and use, corporation and other taxes, federal grants, federal reimbursements and other reimbursements for use of materials and services. Revenues from other financing sources are recognized when received. Expenditures are recorded in the period in which the related fund liability is incurred. Principal and interest on general long-term obligations are recorded as fund liabilities when due.

Financial Statement Presentation

The Commonwealth presents the following major governmental funds:

The General Fund is the primary operating fund of the Commonwealth. It is used to account for all governmental transactions, except those required to be accounted for in another fund.

The Local Aid Fund accounts for the lottery operating surplus and forty percent of income and corporate taxes, thirty two percent of sales tax and a portion of other taxes which have been earmarked for distribution to municipalities or used to finance programs that benefit local communities and a major portion of the court systems.

The Lottery Funds account for the operations of the State and Arts Lotteries, which primarily finance the aforementioned local aid fund.

The Debt Service Fund accounts for the accumulation of resources, principally transfers from other funds, for the payment of long-term debt principal and interest.

Capital Projects – Highway accounts for the proceeds of bonds sold to finance construction of state highways and to fund the Commonwealth's share of Federally sponsored highway construction.

The Central Artery and Statewide Road and Bridge Fund accounts for the construction of a portion of the Central Artery / Tunnel project financed from fiscal 2001 forward, as well as various other statewide road and bridge projects. These expenditures are financed from bond proceeds, certain revenues from Registry of Motor Vehicles fees (net of debt service expenditures) and payments from authorities.

Additionally, the Commonwealth reports the following fund types:

Governmental Fund Types:

Special Revenue Funds account for specific revenue sources that have been aggregated according to Commonwealth Finance Law to support specific governmental activities.

Capital Projects Funds account for the acquisition or construction of major Commonwealth capital facilities financed by primarily from bonds and federal reimbursements.

Permanent Funds report resources that are legally restricted to the extent that only earnings and not principal, may be used for purposes that benefit the government or its citizens.

Internal Service Funds report the financing of services by one department or agency to other departments or agencies or to other governmental units.

Proprietary Fund Types:

The Unemployment Compensation Fund reports the taxes collected from employers and held by the United States Treasury in the Federal Unemployment Trust Fund, from which funds are drawn for the payment of benefits to the unemployed.

The College and University Information is presented here, aggregated by the University's activity, the State Colleges activity and the Community College's activity.

Fiduciary Fund Types:

Pension (and other employee benefits) trust funds report resources that are required to be held in trust for the members and beneficiaries of the Commonwealth's pension plans. These include the State Employees' and Teachers' Retirement Systems and assets held in trust for the cities and towns.

Private Purpose Trust Funds report resources of all other arrangements held by the Commonwealth in a trustee capacity, or as an agent for individuals, private organizations, other governmental units, and/or other funds in which principal and income are available to be spent for a designated purpose

The **External Investment Trust Fund** accounts for the portion of pooled cash held under the custodianship of the Commonwealth for the benefit of cities, towns and other political subdivisions of the Commonwealth.

Agency Funds account for assets the Commonwealth holds on behalf of others. Agency Funds are custodial in nature and do not involve measurement of operations.

Statutory (budgetary) Accounting – The Commonwealth's books and records and other official reports are maintained on the basis of accounting used in the preparation of the Commonwealth's legally adopted annual budget (statutory basis). The statutory basis emphasizes accountability and the budgetary control of appropriations, but is not intended to present the Commonwealth's financial condition and results of operations in conformity with GAAP.

Under the statutory basis, revenues are generally recognized when the cash deposit is received. However, revenues receivable for federal grants and reimbursements are recognized when related expenditures are incurred. Amounts due from certain political subdivisions of the Commonwealth are recognized when considered measurable and available at year-end. Deeds excise taxes are recognized at the time of collection by the counties and the Commonwealth.

Statutory expenditures generally are recorded when the related cash disbursement occurs. At year-end, payroll is accrued and payables are recognized, to the extent of approved encumbrances, for goods or services received by June 30. Costs incurred under the federally sponsored Medicaid program, amounts required to settle claims and judgments against the Commonwealth, and certain other liabilities are not recognized until they are encumbered or otherwise processed for payment. All encumbrances that do not relate to specific payables lapse at year-end.

The Commonwealth has separately published its audited "Statutory Basis Financial Report" for the fiscal year June 30, 2001, dated October 24, 2001.

Fiscal Year- Ends

All funds and discretely presented component units are reported using fiscal years, which end on June 30, except for the Massachusetts Turnpike Authority, and the Commonwealth of Massachusetts Deferred Compensation Plan, both of which utilize a December 31 year end.

D. Assets, Liabilities and Net Assets / Fund Balance***Cash and Short-Term Investments and Investments -***

The Commonwealth follows the practice of pooling cash and cash equivalents for some of its Governmental and Fiduciary Funds. Cash equivalents consist of short-term investments with an original maturity of three months or less and are stated at cost or amortized cost, which approximates fair value. Interest earned on pooled cash is allocated to the General Fund, Private Purpose Trust Funds and to certain Special Revenue Funds when so directed by law. All Commonwealth, Component Unit, Pension and Deferred Compensation Plan investments are carried at fair value determined by current market rates and quotations.

The Pension (and other employee benefits) Trust Funds, with investments totaling approximately \$29,279,535,000, at fair value, are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. For investments traded in an active market, the fair value of the investment will be its market price. The Pension (and other employee benefit) Trust Funds include investments in real estate, venture capital funds, real estate funds, limited partnerships, futures pools, international hedge pools, commodities pools, balanced pools, leveraged buyouts, private placements and other alternative investments. The structure, risk profile, return potential and marketability differ from traditional equity and fixed income investments. Concentrations of credit risk exist if a number of companies in which the Fund has invested, are engaged in similar activities and have similar economic characteristics that could cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. To mitigate the exposure to concentrations of risk, the Pension (and other employee benefit) Trust Funds invest in a variety of industries located in diverse geographic areas. As of June 30, 2001, the estimated fair value, determined by management with input from the investment managers, of these real estate and alternative investments was approximately \$3,423,332,000 in the Pension (and other employee benefits) Trust Funds, representing 8.0%, of the total assets of the Fiduciary Fund Type.

The Commonwealth maintains a short-term investment pool established by the State Treasurer on June 8, 1977 through a Declaration of Trust. The investments are carried at amortized cost, which approximates fair value. The primary government's and component unit's share are reported as short-term investments within their respective reporting categories. The various local governments and other political subdivisions share of net asset is approximately \$2,890,323,000 is reported as an External Investment Trust within the Fiduciary Fund Type.

Included in the discretely presented Component Units is approximately \$882,322,000 in investments, whose valuation was determined by management. In making its valuations, management considered the cost of investments, current and past operating results, current economic conditions and their effect on the borrowers, estimated realizable values of collateral, and other factors pertinent to the valuation of investments. There is no public market for most of the investments. Management, in making its evaluation, has in many instances relied on financial data and on estimates by management of the companies they have invested in as to the effect of future developments.

Investments of the University of Massachusetts (UMass) are stated at fair value. Annuity contracts represent guaranteed investment contracts and are carried at present value. Investments of the Commonwealth's Employees Deferred Compensation Plan are carried at fair value.

E. Securities Lending Program

The Pension (and other employee benefits) Trust Funds participate in securities lending programs. Under these programs, the Trusts receive a fee for allowing brokerage firms to borrow certain securities for a predetermined period of time, securing such loans with cash or collateral typically equaling 102% to 105% of the market value of the security borrowed. At June 30, 2001, the market value of the securities on loan from PRIT was approximately \$1,013,676,000. The value of the collateral held by PRIT amounted to approximately \$1,077,746,000 at June 30, 2001. The PRIT trust securities on loan were collateralized at all times by U.S. Treasury securities of at least 100% of the value of the loaned securities. The collateral securities cannot be pledged or sold by PRIT unless the borrower defaults. The securities lending agents indemnify PRIT in the event that the agents fail to return the securities lent or if the collateral is inadequate to replace the securities lent. PRIT does not believe it has credit risk exposure to the borrower because the amounts PRIT owes the borrower exceeds the amounts the borrower owes PRIT. The securities on loan are included in investments at fair value as of June 30, 2001 in the combined balance sheet.

F. Receivables

In general, tax revenue is recognized on the government-wide statements, when assessed or levied and on the governmental financial statements to the extent that it is both measurable and available. Receivables are stated net of estimated allowances for uncollectible accounts. Reimbursements due to the Commonwealth for its expenditures on federally funded reimbursement and grant programs are reported as "Due from federal government."

G. Due From Cities and Towns

These amounts represent reimbursement due to the Commonwealth for its expenditures on certain programs for the benefit of cities and towns.

Inventories included in the Governmental Fund Types represent food stamps on hand and are stated at face value.

H. Inventories and Other Assets

The costs of materials and supplies are recorded as expenditures in Governmental Funds when purchased.

I. Fixed Assets

For Governmental Funds, general fixed asset acquisitions are recorded as expenditures in the acquiring fund and capitalized in the year purchased. Fixed assets are recorded at historical cost, or at estimated historical cost if actual historical cost is not available. Donated fixed assets are recorded at the estimated fair market value at the date of the donation.

The cost of normal maintenance and repairs that do not add to the value of the assets or materially extend asset lives are not capitalized. Improvements are capitalized.

The Commonwealth capitalizes all land except land associated with infrastructure. It capitalizes buildings in excess of \$100,000 and singular pieces of equipment vehicles and computer software with costs in excess of \$15,000 at the date of acquisition and with expected useful lives of greater than one year. Interest incurred during construction is not material and it is not capitalized. Infrastructure fixed assets such as roads, bridges, tunnels, dams, water and sewer systems are capitalized for the first time with the implementation of GASB 34.

The University of Massachusetts capitalizes all other fixed assets with costs in excess of \$1,000. The community colleges capitalize all other fixed assets with costs in excess of \$15,000 consistent with the Commonwealth's fixed asset policy. All fixed assets are depreciated on a straight-line basis over the estimated useful lives of the assets.

Fixed assets of the Component Units are capitalized upon purchase and depreciated on a straight-line basis over the estimated useful lives of the assets. Interest incurred during construction is capitalized.

J. Interfund/Intrafund Transactions

As a general rule, the effect of interfund activity has been eliminated from the government-wide statements. Exceptions to this rule are: 1) activities between funds reported as governmental activities and funds reported as business-type activities and 2) activities between funds that are reported in different functional categories in either the governmental or business-type activities column. Elimination of these activities would distort the direct costs and program revenues for the functions concerned.

Interfund receivables and payables have been eliminated from the Statement of Net Assets, except for the residual amounts due between governmental and business-type activities.

Receivables and payables resulting from transactions between Component Units and the primary government are classified as “Due to/from primary government” or “Due to/from component units.”

K. Statewide Cost Allocation Plan – Fringe Benefit Cost Recovery

Certain costs of nine “central service” agencies of the Commonwealth are recovered from the remaining agencies in a federally approved statewide cost allocation plan. These costs that are allocated are based upon benefits received by the user agency that benefits from these services. The Commonwealth also appropriates and pays the fringe benefit costs of its employees and retirees through the General Fund. These fringe benefits include the costs of employees’ group health insurance, pensions, unemployment compensation and other costs necessary to support the workforce. As directed by Massachusetts General Laws, these costs are assessed to other funds based on payroll costs, net of credits for direct payments. Since fringe benefit costs are not separately appropriated or otherwise provided for in these funds, the required assessment creates an unfavorable budget variance in the budgeted funds. The employees’ group health insurance and worker’s compensation activity is accounted for in the governmental funds. The Commonwealth has elected not to present its cost allocation and recovery separately in the Statement of Activities.

L. School Construction Grants Payable

The Commonwealth, through legislation, is committed to reimburse certain cities, towns and regional school districts for a portion of their debt service costs for school construction and renovation. For the statement of net assets, this amount is recorded as a long-term liability with the amount to be paid during the next fiscal year reported currently. For the governmental fund statements, the amounts expected to be liquidated with available financial resources are reported as expenditures in fund liabilities.

M. Compensated Absences

For the statement of net assets, this amount is recorded as a long-term liability with the amount to be paid during the next fiscal year reported currently. For the governmental fund statements for governmental funds and Private Purpose Trust Funds, vested or accumulated vacation and sick leave expected to be liquidated with expendable available financial resources are reported as expenditures and fund liabilities.

Employees are granted vacation and sick leave in varying amounts based on collective bargaining agreements and state laws. Upon retirement, termination or death, certain employees are compensated for unused vacation and sick leave (subject to certain limitations) at their current rate of pay.

N. Lottery Revenue and Prizes

Ticket revenues and prizes awarded by the Massachusetts Lottery Commission are recognized as drawings are held. For certain prizes payable in installments, the Commonwealth purchases annuities and principal-only and interest-only

treasury strips in the Commonwealth's name, which are recorded as annuity contracts and prizes payable in the Agency Funds. Though the annuities are in the Commonwealth's name, they are solely for the benefit of the prizewinner. The Commonwealth has no claim on the The Commonwealth retains the risk related to such annuities.

O. Risk Financing

The Commonwealth does not insure for employees workers' compensation, casualty, theft, tort claims and other losses. Such losses, including estimates of amounts incurred but not reported, are included as accrued liabilities in the accompanying financial statements when the loss is incurred. For employee's workers' compensation, the Commonwealth assumes the full risk of claims filed under a program managed by the Human Resources Division. For personal injury or property damages, Massachusetts General Laws limit the risk assumed by the Commonwealth to \$100,000 per occurrence, in most circumstances. The Group Insurance Commission administers health care and other insurance for the Commonwealth's employees and retirees. The Internal Service Funds account for workers' compensation and group insurance risk financing activities.

P. Net Assets

The Commonwealth reports net assets as reserved where legally restricted for a specific future use. Otherwise, these balances are considered unrestricted.

Fund balances have been reserved as follows:

"Reserved for employees' pension benefits" – identifies the net assets of the Commonwealth's public employee retirement systems, which cannot be used for any other purpose.

"Reserved for unemployment benefits" – identifies amounts reserved for payment of unemployment compensation.

"Reserved for retirement of indebtedness" – identifies amounts held by fiscal agents to fund future debt service obligations pertaining to Special Obligation Revenue Bonds authorized under Section 20 of Chapter 29 of the Massachusetts General Laws and Chapter 33, Acts of 1991 and Grant Anticipation Notes authorized by Chapter 11 of the Acts of 1997 and Chapter 121 of the Acts of 1998.

"Reserved for nonexpendable trusts" – identifies amounts being held by the Commonwealth on behalf of third parties for which only the interest can be expended.

"Reserved for capital projects" – identifies amounts reserved for capital projects.

"Reserved for investment pool participants" – accounts for assets held for governmental entities and other local governmental and political subdivisions, in an external investment trust.

Q. Reclassifications

During fiscal 2001 and 2002, the Commonwealth implemented the following new accounting standards issued by the GASB:

During Fiscal 2001

Statement No. 33 Accounting and Financial Reporting for Non-exchange Transactions

Statement No. 36 Recipient Reporting for Certain Shared Non-exchange Revenues

The provisions of these standards had no material effect on the Commonwealth's governmental funds. The standards required the Commonwealth's component units, however, to recognize grants and contributions as non-operating revenue on the former statements of revenues, expenses and changes in retained earnings. In prior periods, grants and contributions had been recorded as a direct increase in aid in the net asset section of the balance sheet. The total effect on the Commonwealth's financial statements of these entities adopting the provisions of GASB 33 during fiscal year 2001 was approximately \$451,000,000.

During Fiscal 2002

Statement No. 34 Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments. Statement No. 34, as amended by Statement No. 37, establishes new financial reporting standards for state and local governments. The statement's requirements represent a significant change in the financial reporting model used by governments, including statement formats and changes in fund types and account groups. In addition to the traditional fund financial statements, governments are required to report government-wide financial statements, prepared using the accrual basis of accounting and the economic resources measurement focus. As a result, fund reclassifications and adjustments to the fund equities reported in the prior financial statements were required.

Statement No. 35 Basic Financial Statements – and Management's Discussion and Analysis – For Public Colleges and Universities. Statement No. 35, establishes financial reporting standards for public colleges and universities within the guidelines of Statements Nos. 34 and 37. The institutions of higher education in the Commonwealth, reported as business-type activities, adopted the requirements of Statement 35.

Statement No. 37 Basic Financial Statements – and Management's Discussion and Analysis – Omnibus

Statement No. 38 Certain Financial Note Disclosures. Statement No. 38 requires certain note disclosures when Statement No. 34, 35 and 37 is implemented.

To conform with these statements, the following amounts have been reclassified and beginning balances have been restated (amounts in thousands):

	June 30, 2001 As Previously Reported	Fund Reclassifications	Accounting Adjustments	June 30, 2001 As Restated
GOVERNMENTAL FUNDS AND ACTIVITIES				
Major Funds:				
General Fund	\$ 2,730,216	\$ -	\$ -	\$ 2,730,216
Previously Reported as Special Revenue Funds:				
Local Aid	-	127,098	-	127,098
Lotteries	-	(13,017)	-	(13,017)
Previously Reported as Debt Service Fund:				
Debt Service	-	-	-	-
Previously Reported as Capital Project Funds:				
Highway Capital Projects	-	(849,605)	-	(849,605)
Central Artery Statewide Road and Bridge	-	1,637,373	-	1,637,373
Total Major Funds	2,730,216	901,849	-	3,632,065
Non Major Funds:				
Special Revenue Funds:				
Federal Grants	(6,245)	-	-	(6,245)
Highway	(265,289)	-	-	(265,289)
Local Aid	127,098	(127,098)	-	-
Environmental	(53,914)	-	-	(53,914)
Lotteries	(13,017)	13,017	-	-
Universal Health Care	153,679	-	-	153,679
Other	1,086,496	-	-	1,086,496
Total Special Revenue Fund Balances	1,028,808	(114,081)	-	914,727
Debt Service Fund				
Debt Service	-	-	-	-
Total Debt Service Fund Balances	-	-	-	-
Capital Project Funds:				
General	(107,117)	-	-	(107,117)
Capital Investment Trust	3,851	-	-	3,851
Convention and Exhibition Center	(154,832)	-	-	(154,832)
Capital Improvements and Investment Trust	108,133	-	-	108,133
Capital Expenditure Reserve	(143,427)	-	-	(143,427)
Highway	(849,605)	849,605	-	-
Federal Highway Construction	(280)	-	-	(280)
Central Artery Statewide Road and Bridge	1,637,373	(1,637,373)	-	-
Capital Needs Investment Trust	16,017	-	-	16,017
Government Land Bank	(6,300)	-	-	(6,300)
Intercity Bus Capital	(3,531)	-	-	(3,531)
Local Aid Capital Projects	(3,823)	-	-	(3,823)
Total Capital Project Fund Balances	496,459	(787,768)	-	(291,309)
Fiduciary Fund Type - Expendable Trust				
Deferred Compensation Trust	3,112,410	(3,112,410)	-	-
Unemployment Compensation	2,321,611	(2,321,611)	-	-
Expendable Trust	210,832	-	-	210,832
Revolving Loan	12,693	-	-	12,693
Teacher, Principal, Superintendent				
Quality Endowment	72,790	(72,790)	-	-
Total Fiduciary Fund Type Fund Balances	5,730,336	(5,506,811)	-	223,525
Previously Reported as Proprietary Fund Type:				
Internal Service Funds	-	(247,296)	-	(247,296)
Permanent Funds				
Previously Reported as Fiduciary Fund Type - Expendable Trust:				
Teacher, Principal, Superintendent Quality Endowment	-	72,790	-	72,790
Total Non-Major Funds	7,255,603	(6,583,166)	-	672,437
Total Governmental funds	9,985,819	(5,681,317)	-	4,304,502
Adoption of GASB Statement No. 33 and 34				
Revenue recognition	-	-	291,992	291,992
Capital assets net of depreciation	-	-	16,996,737	16,996,737
General obligation bonds	-	-	(13,999,454)	(13,999,454)
Accrued interest on bonds	-	-	(191,666)	(191,666)
Due to component units - Central Artery / Tunnel Project	-	-	(8,293,818)	(8,293,818)
School construction grants payable	-	-	(3,307,134)	(3,307,134)
Accrued interest on school construction grants	-	-	(243,640)	(243,640)
Other liabilities and long-term obligations	-	-	(371,848)	(371,848)
Adoption of GASB Statement No. 33 and 34	\$ -	\$ -	\$ (9,118,831)	\$ (9,118,831)
TOTAL GOVERNMENT FUNDS AND ACTIVITIES	\$ 9,985,819	\$ (5,681,317)	\$ (9,118,831)	\$ (4,814,329)

	June 30, 2001 As Previously Reported	Fund Reclassifications	Accounting Adjustments	June 30, 2001 As Restated
PROPRIETARY FUNDS AND BUSINESS-TYPE ACTIVITIES				
Major Funds:				
Previously Reported as Fiduciary Fund Type - Expendable Trust:				
Unemployment Compensation	\$ -	\$ 2,321,611	\$ -	\$ 2,321,611
Previously Reported as University and College Fund Type				
Higher Education	-	3,066,949	-	3,066,949
Total major funds	-	5,388,560	-	5,388,560
Non Major Funds:				
Internal Service Funds	(100,060)	100,060	-	-
Total Proprietary and Business-Type Funds	\$ (100,060)	\$ 5,488,620	\$ -	\$ 5,388,560
Adoption of GASB Statement No. 33 and 34				
Capital assets net of depreciation	\$ -	\$ -	\$ (1,650,926)	\$ (1,650,926)
Other accounting changes	-	-	16,592	16,592
Adoption of GASB Statement No. 33 and 34	-	-	(1,634,334)	(1,634,334)
TOTAL PROPRIETARY FUNDS AND BUSINESS	(100,060)	5,488,620	(1,634,334)	3,754,226
- TYPE ACTIVITIES	(100,060)	5,488,620	(1,634,334)	3,754,226
TOTAL PRIMARY GOVERNMENT	\$ 9,885,759	\$ (192,697)	\$ (10,753,165)	\$ (1,060,103)
OTHER ADJUSTMENTS				
FIDUCIARY FUND TYPE				
Pension Trust Funds				
Pension Trust Funds	\$ 29,503,347	\$ -	\$ -	\$ 29,503,347
External Investment Trust Funds				
External Investment Trust	2,890,323	-	-	2,890,323
Private Purpose Funds				
Non Expendable Trust	-	5,834	-	5,834
Owner Controlled Insurance				
Program	-	147,236	-	147,236
Agency Funds				
Agency Funds	-	-	-	-
Funds previously reported as:				
Non Expendable Trust	5,834	(5,834)	-	-
TOTAL FIDUCIARY FUNDS	\$ 32,399,504	\$ 147,236	\$ -	\$ 32,546,740
UNIVERSITY AND COLLEGE FUND TYPE				
University and Colleges	\$ 3,066,949	\$ (3,066,949)	\$ -	\$ -
TOTAL UNIVERSITY AND COLLEGE FUND TYPE	\$ 3,066,949	\$ (3,066,949)	\$ -	\$ -
ACCOUNT GROUPS				
General Fixed Assets	\$ 4,010,561	\$ -	\$ -	\$ 4,010,561
General Long-term Obligations	-	-	-	-
Total Account Groups	4,010,561	-	-	4,010,561
Adoption of GASB Statement No. 33 and 34				
Capital assets	-	-	(4,010,561)	(4,010,561)
Total Account Groups	4,010,561	-	(4,010,561)	-
TOTAL OTHER ADJUSTMENTS	\$ 39,477,014	\$ (2,919,713)	\$ (4,010,561)	\$ 32,546,740

2. BUDGETARY CONTROL

State finance law requires that a balanced budget be approved by the Governor and the Legislature. The Governor presents an annual budget to the Legislature, which includes estimates of revenues and other financing sources and recommended expenditures and other financing uses. The Legislature, which has full authority to amend the budget, adopts an expenditure budget by appropriating monies at the individual appropriation account level in an annual appropriations act.

Before signing the appropriations act, the Governor may veto or reduce any specific item, subject to legislative override. Further changes to the budget established in the annual appropriations act may be made via supplemental appropriations acts or other legislative acts. These must also be signed by the Governor and are subject to the line item veto.

In addition, Massachusetts General Laws authorize the Secretary of Administration and Finance, with the approval of the Governor, upon determination that available revenues will be insufficient to meet authorized expenditures, to withhold allotments of appropriated funds, which effectively reduce the account's expenditure budget.

The majority of the Commonwealth's appropriations are non-continuing accounts, which lapse at the end of each fiscal year. Others are continuing accounts for which the Legislature has authorized that an unspent balance from the prior year be carried forward and made available for spending in the current fiscal year. In addition, the Legislature may direct that certain revenues be retained and made available for spending within an appropriation. Fringe benefits and other costs that are mandated by state finance law are not itemized in the appropriation process and are not separately budgeted.

The original fiscal year 2001 appropriations act, Chapter 159, Acts of 2000, and authorized \$20,523,689,000 in direct appropriations. In addition, the act contained \$955,049,000 in authorizations to retain and expend certain non-tax revenues of which \$938,804,000 was estimated to be collected and expended. The Act also included \$121,074,000 in interagency chargebacks. Chapter 159 included estimates of \$15,203,800,000 in tax revenues and approximately \$6,383,045,000 in non-tax revenues. With these revenues (exclusive of chargebacks) projected to total approximately \$21,586,845,000 and with unreserved balances of approximately \$391,328,000 carried forward from the fiscal year 2000, the budget as presented in this original appropriation act was considered to be in balance.

Section 3 of Chapter 236, of the Acts of 2000, which was a supplemental budget for 2000, also authorized any excess funds from the final 2000 reconciliation of lottery revenues be carried forward and distributed to cities and towns. This amount totaled approximately \$955,000.

During fiscal year 2001, the Legislature also passed and the Governor signed, with some modification through veto, Chapters 196, 236, 311, 316, 354, 378, 384 and 410 of the Acts of 2000 and Chapters 3, 7, 8, 15 and 24 of the Acts of 2001, which included numerous supplemental budgetary appropriations. These supplements added \$606,273,000 of indirect appropriations and \$55,022,000 in retained revenue authorizations.

Subsequent to June 30, 2001, the Legislature passed and the Governor signed Chapters 88 of the Acts of 2001, which included \$164,150,000 in additional supplemental appropriations and \$1,337,000 in additional retained revenue authorizations. The cumulative fiscal year 2001 appropriations, retained revenues and interagency chargebacks totals \$22,427,549,000. Appropriations continued from fiscal year 2000 totaled approximately \$252,466,000 and certain interfund transfers directed by statute totaled approximately \$760,545,000.

Because revenue budgets are not updated subsequent to the original appropriation act, the comparison of the initial revenue budget to the subsequent, and often modified, expenditure budget can be misleading. Also, these financial statements portray fund accounting with gross inflows and outflows, thus creating a discrepancy to separately published budget documents. In conducting the budget process, the Commonwealth excludes those interfund transactions that by their nature have no impact on the combined fund balance of the budgeted funds.

Generally, expenditures may not exceed the level of spending authorized for an appropriation account. However, the Commonwealth is statutorily required to pay debt service, regardless of whether such amounts are appropriated. In addition, certain interfund assessments to allocate fringe benefits and other costs that are mandated by state finance law are not itemized in the appropriation process or separately budgeted.

3. DEPOSITS AND INVESTMENTS

Cash and Short-term Investments –The Commonwealth maintains a cash and short-term investment pool, which is utilized by the Governmental and Fiduciary Fund types.

Primary Government -

As of June 30, 2001, the carrying amount of the Primary Government's total cash and cash equivalents was \$1,080,918,000 and the corresponding bank balance was \$1,159,799,000. Bank deposits in the amount of \$5,672,000 were insured by the Federal Deposit Insurance Corporation, \$124,934,000 were collateralized in the name of the Commonwealth and are held by various financial institutions. Deposits of \$1,029,193,000 were uninsured and uncollateralized.

Component Units -

As of June 30, 2001, the carrying amount of the discretely presented Component Unit's total cash and cash equivalents was \$1,796,578,000 and the corresponding bank balances were \$1,444,877,000. Bank deposits of \$174,844,000 were insured by the Federal Deposit Insurance Corporation, \$941,000 were collateralized in the name of the respective component units, and \$1,269,092,000 were uninsured and uncollateralized.

Investments – The investments are reported at fair value in the financial statements. The deposits and investments of the Component Units and the University and College Funds and the investments of the Pension (and other employee benefit) Trust Funds are held separately from those of other Commonwealth funds, with the exception of their investments in MMDT.

Statutes authorize the Primary Government to invest in obligations of the U.S. Treasury, authorized bonds of all states, bankers' acceptances, certificates of deposit, commercial paper rated within the three highest classifications established by Standard & Poor's Corporation and Moody's Commercial Paper Record and repurchase agreements secured by any of these obligations. The Pension (and other employee benefit) Trust Funds are permitted to make investments in equity securities, fixed income securities, real estate and other alternative investments. In the following table, these alternative investments, venture capital and futures pools are classified as other investments. The investment policies of the Component Units are the same as the Primary Government's, except that they permit investment in equity securities.

Short-term investments and investments are classified as to collateral risk into the following three categories:

Category 1: Insured or registered, or securities held by the Commonwealth or its agent in the Commonwealth's name.

Category 2: Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Commonwealth's name.

Category 3: Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the Commonwealth's name.

Primary Government – Investments of the Government at June 30, 2001, were as follows (amounts in thousands):

	Category 1	Category 2	Category 3	Total
<u>Investment</u>				
Repurchase agreements.....	\$ 893,885	\$ 2,069	\$ 49,051	\$ 945,005
U.S. Treasury obligations.....	2,025,746	14,593	-	2,040,339
Commercial paper.....	5,795,279	-	-	5,795,279
Government obligations.....	4,121,730	22,171	855	4,144,756
Equity securities.....	18,045,859	3,567	22,194	18,071,620
Fixed income securities.....	3,569,616	102	131,594	3,701,312
Asset backed investments....	78	-	35	113
Notes.....	571,492	-	-	571,492
Other.....	-	5,133	7,365	12,498
	<u>\$35,023,685</u>	<u>\$ 47,635</u>	<u>\$211,094</u>	<u>35,282,414</u>
Money market investments.....				797,440
Mutual fund investments.....				53,084
Annuity contracts.....				1,409,121
Real estate.....				1,732,287
Assets held in trust.....				2,323,446
Deposits with U.S. Treasury.....				2,171,193
Negotiable Certificates of Deposits.....				150,256
Other.....				1,692,078
Total.....				<u>\$45,611,319</u>

Following is a reconciliation of investments held by the Government (amounts in thousands):

Governmental Activity.....	\$ 5,993,631
Business Type Activity.....	362,702
Fiduciary Funds.....	<u>40,105,263</u>
	46,461,596
Less: Cash held by Fiduciary Funds.....	<u>850,277</u>
Total Investments.....	<u>\$ 45,611,319</u>

Financial Investments with Off-Balance Sheet Risk – Certain investments of the Commonwealth may involve a degree of risk not accounted for on the respective financial statements. A description of such “off-balance sheet risks” is as follows.

i) Forward Currency Contracts – The Pension (and other employee benefit) Trust Funds enter into forward currency contracts to hedge the exposure to changes in foreign currency exchange rates on foreign portfolio holdings. The market value of the contract will fluctuate with changes in currency exchange rates.

The contract is marked-to-market daily and the change in market value is recorded by the fund as an unrealized gain or loss by the Pension Trust Fund.

When the contract is closed, the Pension (and other employee benefit) Trust Funds record a realized gain or loss equal to the difference between the value of the contract at the time it was opened and the value at the time it was closed. The maximum potential loss from such contract is the aggregate face value in U.S. dollars at the time the contract was opened.

ii) Futures Contracts – The Pension (and other employee benefit) Trust Funds may purchase and sell financial futures contracts to hedge against changes in the values of securities the fund owes or expects to purchase. Upon entering such contracts, they must pledge to the broker an amount of cash or securities equal to the minimum “initial margin” requirements of the futures.

The potential risk is that the change in the value of futures contracts primarily corresponds with the value of underlying instruments, which may not correspond to the change in value of the hedged instruments. In addition, there is a risk that PRIT may not be able to close out its futures positions due to a nonliquid secondary market. Risks may arise from the potential inability of a counterparty to meet the terms of a contract and from unanticipated movements in the value of a foreign currency relative to the U.S. dollar. The Pension (and other employee benefit) Trust Funds may also invest in financial futures contracts for nonhedging purposes.

Payments are made or received by the Pension (and other employee benefit) Trust Funds each day, depending on the daily fluctuations in the value of the underlying security, and are recorded as unrealized gains or losses. When the contracts are closed, the Pension (and other employee benefit) Trust Funds recognize a gain or loss. The notional value of the futures contracts at June 30, 2001 for the Pension (and other employee benefit) Trust Funds was approximately \$212,922,000 resulting with an unrealized loss of approximately \$559,000.

At June 30, 2001, U. S. Treasury Bills, U. S. Treasury Inflation Indexed Notes and asset-backed securities with principle of \$10,885,000, \$1,500,000, and \$2,600,000, respectively, were pledged to cover margin requirements for open futures contracts.

iii) Options – PRIT is also engaged in selling or “writing” options. The Pension (and other employee benefit) Trust Funds, as writers of options, may have no control over whether the underlying securities may be sold (call) or purchased (put) and, as a result, bear the market risk of an unfavorable change in the price of the security underlying the written option. As of June 30, 2001, there were no material options outstanding.

Component Units – Investments of the discretely presented Component Units at June 30, 2001 are as follows (amounts in thousands):

	Category 1	Category 2	Category 3	Total
<u>Investment</u>				
Repurchase agreements.....	\$ 5,500	\$ 317,385	\$ 3,226	\$ 326,111
U.S. Treasury obligations..	101,645	-	-	101,645
Commercial paper.....	184,829	-	-	184,829
Government obligations....	274,063	393,752	25,790	693,605
Equity securities.....	-	-	1,630	1,630
Fixed income securities.....	-	-	516	516
Asset backed investments	-	-	-	-
Notes.....	23,516	-	6,188	29,704
Other.....	-	-	4,784	4,784
	<u>\$589,553</u>	<u>\$ 711,137</u>	<u>\$ 42,134</u>	1,342,824
Assets held in trust.....				6,137
Guaranteed investment contracts.....				834,665
Negotiable Certificate of deposits.....				14,821
Total.....				<u>\$ 2,198,447</u>

Following is a reconciliation of investments as summarized above to the balance as recorded in the combined balance sheet (amounts in thousands):

Investments as summarized above.....	\$ 2,198,447
Less:	
Short-term investments reported in the combined balance sheet as cash and short-term investments.....	512,606
Restricted investments reported separately in the combined balance sheet.....	797,382
Assets held in trust reported separately in the combined balance sheet.....	6,137
Investments as reported in the combined balance sheet...	<u>\$ 882,322</u>

Following is a reconciliation of the balance of cash and short-term investments at June 30, 2001 (amounts in thousands):

Carrying amount of cash and cash equivalents.....	\$ 1,796,578
Short-term investments reported as cash and cash equivalents.....	<u>512,606</u>
Cash and cash equivalents as reported in the combined balance sheet.....	<u>\$ 2,309,184</u>

4. RECEIVABLES

Taxes, federal reimbursements, loans and other receivables are presented in the various funds as follows (amounts in thousands):

Primary Government –

	Taxes Receivable	Due From Federal Government	Other Receivables	Loans	Allowance For Uncollectibles	Net Accounts Receivable
Primary Government						
Governmental Activities	\$ 1,846,789	\$ 1,103,024	\$ 881,649	\$ -	\$ (910,049)	\$ 2,921,413
Business Type Activities	301,976	24,940	246,284	58,855	(175,847)	456,208
Total Receivables	2,148,765	1,127,964	1,127,933	58,855	(1,085,896)	3,377,621
Less: Allowances	(424,792)	(8,390)	(645,106)	(7,608)		
Net Primary Government Receivables	\$ 1,723,973	\$ 1,119,574	\$ 482,827	\$ 51,247		\$ 3,377,621

Discretely Presented Component Units –

	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Massachusetts Water Pollution Abatement Trust	NonMajor Component Units	Total
Receivables, net of allowance for uncollectibles:					
Federal grants and reimbursement receivable	\$ -	\$ -	\$ 91,446	\$ 19,325	\$ 110,771
Less: Allowance for uncollectibles	-	-	-	-	-
Net Federal grants and reimbursement receivable	-	-	91,446	19,325	110,771
Loans	-	-	1,734,657	328,152	2,062,809
Less: Allowance for uncollectibles	-	-	-	(18,854)	(18,854)
Net Loans	-	-	1,734,657	309,298	2,043,955
Other receivables	15,297	20,616	46,109	36,729	118,751
Less: Allowance for uncollectibles	-	(642)	-	(414)	(1,056)
Net Other receivables	15,297	19,974	46,109	36,315	117,695
Total Receivables, net of allowance for uncollectibles	15,297	19,974	1,872,212	364,938	2,272,421
Less: Current portion	(15,297)	(19,974)	(227,426)	(70,661)	(333,358)
Long term portion	\$ -	\$ -	\$ 1,644,786	\$ 294,277	\$ 1,939,063

5. RECEIVABLES AND PAYABLES BETWEEN FUNDS AND COMPONENT UNITS

Receivables and payables between funds and component units reflected as due to/from primary government/component units in the combined balance sheet at June 30, 2001 are summarized as follows (amounts in thousands):

<i>Primary Government:</i>		<i>Component Units:</i>	
	Due from	Due to	
General Fund:			General Fund:
Special Revenue Funds:			RTAs.....
Federal Grants.....	\$ -	\$ -	MDFA.....
Highway.....	-	-	MCCA.....
Local Aid.....	-	-	MTPC.....
Environmental.....	-	-	Economic Development Entities.....
Capital Projects Funds:			Subtotal.....
General.....	-	-	
Capital Investment Trust.....	-	-	Special Revenue Funds:
Convention and Exhibition Center.....	-	-	MBTA.....
Capital Improvement & Investment Trust.....	-	-	RTAs.....
Capital Expenditure Reserve.....	-	-	Economic Development Entities.....
Highway.....	-	-	Subtotal.....
Federal Highway.....	-	-	
Central Artery Statewide Road and Bridge Infrastructure.....	-	-	Capital Projects Funds:
Intercity Bus.....	-	-	RTAs.....
Capital Needs Investment.....	-	-	Economic Development Entities.....
Local Aid.....	-	-	Subtotal.....
Other.....	-	-	Subtotal - Primary Government.....
University and College Fund:			
Current - Unrestricted.....	-	-	MBTA:
Subtotal.....	-	-	Special Revenue Funds:
			MBTA State and Local Contribution.....
Special Revenue Funds:			Subtotal.....
General Fund.....	-	-	
Special Revenue Funds:			RTAs:
Highway.....	-	-	General Fund.....
Capital Projects Funds:			Special Revenue Funds:
Federal Highway Construction.....	-	-	Highway.....
Other.....	-	-	Local Aid.....
Subtotal.....	-	-	Capital Projects Funds:
Capital Projects Funds:			General Capital Projects.....
General Fund.....	-	-	Subtotal.....
Special Revenue Funds:			
Other.....	-	-	MDFA:
Subtotal.....	-	-	General Fund.....
Internal Service Funds:			Subtotal.....
University and College Funds:			
Current - unrestricted.....	-	-	MCCA:
Subtotal.....	-	-	General Fund.....
University and College Fund:			Subtotal.....
General Fund.....	-	-	
Internal Services Funds:			MTPC:
Employees Workers' Compensation.....	-	-	General Fund.....
University and College Fund:			Subtotal.....
Current - unrestricted.....	-	-	
Current - restricted.....	-	-	Economic Development Entities:
Loan.....	-	-	General Fund.....
Endowment.....	-	-	Special Revenue Funds:
Plant.....	-	-	Local Aid.....
Subtotal.....	-	-	Massachusetts Tourism.....
Total Primary Government.....	\$ -	\$ -	Capital Projects Funds:
			General Capital Projects.....
			Subtotal.....
			Subtotal Component Units.....
			Total Component Units.....
			MBTA:
			Special Revenue Funds:
			MBTA State and Local Contribution.....

All contributions to the Central Artery / Tunnel Project from component units are reflected as additions to construction in process on the various component units' financial statements, pursuant to Massachusetts General Laws, Chapter 81A. The Commonwealth reflects these payments as transfers from component units.

As part of the Commonwealth's implementation of GASB 34, the Commonwealth has recorded the Commonwealth's construction cost to date for the Central Artery / Tunnel Project, net of amounts transferred to the Turnpike Authority (a component unit) and the Massachusetts Port Authority (Massport) (not a component unit.) This amount is reflected as "Construction in Process – Central Artery / Tunnel Project" along with two corresponding liabilities: "Due to Component Units – Central Artery / Tunnel Project" for the Turnpike Authority's portion and "Due to Other – Central Artery / Tunnel Project" for Massport's portion. As portions of the project are completed and transferred to either the Turnpike Authority or Massport in accordance with Massachusetts General Laws, Chapter 81A (MGL 81A) (upon agreement of the various engineers and the Authorities' Boards of Directors), these amounts will be reduced for the value of the assets transferred.

The Turnpike Authority will present its audited financial statements under GASB 34 on a calendar year basis for the year ended December 31, 2001. For fiscal 2001, the Commonwealth had the following payable to Component Units – Central Artery / Tunnel Project activity:

Total Project budget as of June 30, 2001	<u>\$ 14,075,000</u>
I. Determination of Turnpike Authority Amounts:	
Cumulative Authorized Project Invoices as of June 30, 2001	\$ 10,303,660
Less: Amounts to be transferred to Massport as of December 31, 2001	(354,748)
Less: Amounts transferred previous to December 31, 2001 to Massport	(10,252)
Less: Amounts transferred previous to December 31, 2001 to the Turnpike Authority	<u>(1,999,589)</u>
Subtotal - Due to Component Units - Central Artery / Tunnel Project as of June 30, 2001	7,939,071
Less: Construction Expenses January 1 to June 30, 2001	(603,561)
Amounts recognized as contributed by the Turnpike Authority as of December 31, 2000	<u>(1,355,000)</u>
Amounts not recognized as contributed by the Turnpike Authority as of December 31, 2000	<u>\$ 5,980,510</u>
II. Determination of Massport Amounts:	
Massport's Portion of the Central Artery / Tunnel Project as determined under MGL 81A	\$ 365,000
Less: Amounts recognized as Due to Other – Central Artery / Tunnel Project	<u>(354,748)</u>
Amounts transferred to Massport as of June 30, 2001	10,252
Amounts contributed by Massport to the project as of June 30, 2001	<u>\$ 95,288</u>

6. FIXED ASSETS

Primary Government-

Summary of Significant Accounting Policies

Methods used to value capital assets

Capital assets, which include property, plant, equipment and infrastructure (e.g. roads, bridges, ramps and other similar items), are reported in the applicable governmental or business-type activity columns of the government-wide financial statements. Such assets are recorded at historical cost or estimated historical cost if purchased or constructed. Donated capital assets are recorded at fair market value at the date of donation.

Capitalization Policies

All land and non-depreciable land improvements and donated historical treasures or works of art are capitalized, regardless of cost. Singular pieces of equipment, vehicles, computer equipment and software that equal or exceed \$50,000 (\$1,000 for the University of Massachusetts) are capitalized. Buildings and infrastructure projects are capitalized with a cost that equal or exceed \$100,000. The costs of normal maintenance and repairs that do not add to the value of assets or materially extend asset lives are not capitalized.

Depreciation and useful lives

Applicable capital assets are depreciated using the straight-line method with a full year's depreciation charged in the year of acquisition and disposal, regardless of date. Estimated useful lives are as follows:

Type of Asset	Estimated Useful Life (in years)
Buildings	40
Infrastructure – Roads, Bridges, Tunnels	40
Infrastructure – Beaches, Boardwalks, Bikeways etc.	20
Infrastructure – Dams, water and sewer systems	50
Furniture	10
Library Collections that are not historical treasures	15
Equipment, Office Equipment, Life Safety Equipment, Vehicles	5
Computer Hardware and Software	3

Capital asset activities for the fiscal year ended June 30, 2001 are as follows (amounts in thousands):

Governmental Activities

	July 1, 2000 Beginning Balance	Additions	Deletions	June 30, 2001 Ending Balance
Capital assets not being depreciated:				
Land	\$ 579,995	\$ 15,644	\$ 344	\$ 595,295
Construction in process – Commonwealth	33,329	39,097	41,948	30,478
Construction in process – Central Artery / Tunnel Project	7,047,895	1,245,923	-	8,293,818
Total capital assets not being depreciated	7,661,219	1,300,664	42,292	8,919,591
Capital assets being depreciated:				
Buildings	2,648,197	236,957	176,746	2,708,408
Machinery and equipment	656,209	98,968	78,797	676,380
Infrastructure	10,287,633	234,305	-	10,521,938
Total capital assets being depreciated	13,592,039	570,230	255,543	13,906,726
Less accumulated depreciation for:				
Buildings	1,972,255	52,866	-	2,025,121
Machinery and equipment	484,832	21,977	-	506,809
Machinery and equipment under capital leases	67,348	22,153	-	89,501
Infrastructure	2,951,472	256,677	-	3,208,149
Total accumulated depreciation	5,475,907	353,673	-	5,829,580
Total capital assets, being depreciated, net	8,116,132	216,557	255,543	8,077,146
Governmental Activity capital assets, net	\$15,777,351	\$1,517,221	\$297,835	16,996,737

Business Type Activities including Colleges and the University

(in thousands)	July 1, 2000 Beginning Balance	Additions	Deletions	June 30, 2001 Ending Balance
Capital assets not being depreciated:				
Land	\$ 47,278	\$ 1,164	\$ 116	\$ 48,326
Construction in Process	136,410	15,206	27,274	124,341
Historical Treasures	-	536	-	536
Total capital assets not being depreciated	183,687	16,906	27,390	173,204
Capital assets being depreciated:				
Buildings	1,829,672	89,494	542	1,918,624
Machinery and equipment	519,212	92,132	39,395	571,949
Books	123,396	11,780	7,191	127,985
Total capital assets being depreciated:	2,472,279	193,406	47,127	2,618,558
Less accumulated depreciation for:				
Buildings	1,070,186	35,088	-	1,105,274
Machinery and equipment	317,779	58,245	2,681	373,344
Books	69,772	9,138	1,004	77,906
Total accumulated depreciation	1,457,737	102,471	3,684	1,556,524
Total capital assets, being depreciated, net	1,014,542	90,935	43,443	1,062,034
Business-Type Activity capital assets, net	\$ 1,198,230	\$ 107,841	\$ 70,833	\$ 1,235,238

Depreciation expense is not charged to particular functions of the primary government. It is charged in the aggregate.

Discretely Presented Component Units – Fixed assets consist of the following at June 30, 2001 (amounts in thousands):

	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Massachusetts Water Pollution Abatement Trust	NonMajor Component Units	Total
Capital assets					
Land and other non-depreciable assets	\$ 141,819	\$ 72,527	\$ -	\$ 70,725	\$ 285,071
Buildings	6,014,971	487,609	-	497,219	6,999,799
Equipment and Furnishings	1,801,977	62,078	-	244,316	2,108,371
Infrastructure	-	1,355,794	-	30,472	1,386,266
Construction in progress	725,163	797,012	-	288,159	1,810,334
Less: Accumulated depreciation	(2,388,710)	(571,566)	-	(390,353)	(3,350,629)
Property, plant and equipment, net	<u>\$ 6,295,220</u>	<u>\$ 2,203,454</u>	<u>\$ -</u>	<u>\$ 740,538</u>	<u>\$ 9,239,212</u>

7. SHORT-TERM FINANCING AND CREDIT AGREEMENTS

Primary Government -

Massachusetts General Laws authorizes the Treasurer to issue temporary notes in anticipation of revenue or bond financing. When this short-term debt does not meet long-term financing criteria, it is classified as a fund liability. Short-term debt may be issued on either a stand-alone basis or through a commercial paper program maintained by the Commonwealth.

The following table summarizes short-term financing and credit activity for fiscal 2001: (Amounts in thousands)

	July 1, 2000		June 30, 2001		
	Beginning <u>Balance</u>	Issued / <u>Drawn</u>	Redeemed / <u>Repaid</u>	Ending <u>Balance</u>	Credit <u>Limit</u>
Primary Government					
<i>Governmental Funds</i>					
Commercial Paper	\$ -	\$ 720,000	\$ 620,000	\$ 100,000	Not Applicable
Letters of Credit Facilities	-	-	-	-	\$ 200,000
Lines of Credit Facilities	-	-	-	-	400,000
Bond Anticipation Notes	<u>-</u>	<u>400,000</u>	<u>-</u>	<u>400,000</u>	Not Applicable
Total Primary Government	<u>\$ -</u>	<u>\$ 1,120,000</u>	<u>\$ 620,000</u>	<u>\$ 500,000</u>	<u>\$ 600,000</u>
Discretely Presented Component Units					
<i>Major Component Units</i>					
Massachusetts Bay Transportation Authority:					
Bond Anticipation Notes	\$ 160,000	-	\$ 160,000	\$ -	Not Applicable
<i>Minor Component Units</i>					
Regional Transit Authorities					
Revenue Anticipation Notes	<u>78,053</u>	<u>87,513</u>	<u>78,053</u>	<u>87,513</u>	Not Applicable
Total Discretely Presented Component Units	<u>\$ 238,053</u>	<u>\$ 87,513</u>	<u>\$ 238,053</u>	<u>\$ 87,513</u>	

General Fund – Prior to June 30, 2000 the Commonwealth was authorized by Massachusetts General Laws to issue short-term notes to finance working capital advances to the MBTA. As a result of the Forward Funding of the MBTA, the Commonwealth is no longer authorized to provide working capital advances to the MBTA or to finance such advances by issuing short-term notes. Therefore, no such notes were outstanding on June 30, 2001.

The balance of revenue anticipation notes (RANs) outstanding may fluctuate during a fiscal year, but must be reduced to zero at June 30. During fiscal year 2001, no RANs were issued or were outstanding.

Capital Projects Funds – The Commonwealth may issue bond anticipation notes (BANs) to temporarily finance its capital projects.

In September 2000, December 2000, and March of 2001 through its commercial paper program, the Commonwealth issued BANs of \$220,000,000, \$250,000,000 and \$250,000,000, respectively. BANs were rolled over and paid down at various times during the fiscal year. No more than \$250,000,000 of commercial paper obligations was outstanding at any time. On June 30, 2001, \$100,000,000 of BANs was outstanding through the commercial paper program, all of which were retired before July 12, 2001.

In September and October 2001 the Commonwealth issued a combined total of \$250,000,000 of additional BANs through the commercial paper program to temporarily finance capital projects. The balance was paid down to \$50,000,000 as of December 18, 2001.

Letter-of-Credit Agreements – During fiscal year 2001, the Commonwealth maintained a letter-of-credit agreement with a bank in order to provide credit and liquidity support for its commercial paper program. The letter of credit was available to secure up to \$200,000,000 of Commonwealth commercial paper plus interest thereon. Advances were available, subject to certain limitations and bearing interest at the bank rate as defined, in anticipation of revenue or bond proceeds and payable by the following June 30, subject to extension in certain circumstances, at the Commonwealth's option. No such advances were drawn during the fiscal year ended June 30, 2001. The existing letter of credit agreement expires on December 28, 2003. The cost of the facility is approximately 0.15% on both unutilized and utilized amounts.

Line-of-Credit Agreements – During fiscal year 2001, the Commonwealth maintained line-of-credit agreements to provide liquidity support for commercial paper notes. On September 28, 1999, the Commonwealth entered into line-of-credit agreements with two banks to provide a total of \$400,000,000 in liquidity support for the Commonwealth's commercial paper program. These agreements expire in September of 2002 and 2004, respectively. The cost of these facilities is approximately 0.11% on both unutilized and utilized amounts.

On or before December 31, 2001 the Commonwealth expects to establish an additional line of credit for \$200,000,000.

Bonds Anticipation Notes – On September 7, 2000, the Commonwealth sold \$400,000,000 of General Obligation Bond Anticipation Notes, on a stand-alone basis, with an interest rate of 5.0%. The notes matured on September 6, 2001. The notes were issued to finance costs associated with the development of convention centers in Boston and Worcester, although the Commonwealth reserved the right to use the note proceeds to pay other capital costs of the

Commonwealth. The notes were retired on September 6, 2001, from a combination of the proceeds of long-term bonds and additional notes.

Discretely Presented Component Units -

The RTAs had \$87,513,000 short-term notes payable outstanding at June 30, 2001. All the notes mature during fiscal year 2002 and have interest rates ranging from 2.93% to 5.00%.

Subsequent to June 30, 2001, the RTAs rolled over \$45,657,000 of revenue anticipation notes with interest rates ranging from 3.00% to 3.65% due in fiscal year 2002.

8. LONG-TERM DEBT

Under the Constitution of the Commonwealth of Massachusetts, the Commonwealth may borrow money (a) for defense, (b) in anticipation of receipts from taxes or other sources, any such loan to be paid out of the revenue of the year in which the loan is made, or (c) by a two-thirds vote of the members of each house of the Legislature present and voting thereon. The Constitution further provides that borrowed money shall not be expended for any other purpose than that for which it was borrowed or for the reduction or discharge of the principal of the loan. In addition, the Commonwealth may give, loan or pledge its credit by a two-thirds vote of the members of each house of the Legislature present and voting thereon, but such credit may not in any manner be given or loaned to or in aid of any individual, or of any private association, or of any corporation which is privately owned or managed.

The Commonwealth has waived its sovereign immunity and consented to be sued on contractual obligations, including bonds and notes issued by it and all claims with respect thereto. However, the property of the Commonwealth is not subject to attachment or levy to pay a judgment, and the satisfaction of any judgment generally requires legislative appropriation. Enforcement of a claim for the payment of principal or interest on bonds and notes of the Commonwealth may also be subject to the provisions of federal or Commonwealth statutes, if any, enacted to extend the time for payment or impose other constraints upon enforcement.

As of June 30, 2001, the Commonwealth had three types of long-term debt outstanding: general obligation bonds, special obligation bonds and grant anticipation notes.

General Obligation Bonds - are authorized and issued primarily to provide funds for Commonwealth-owned capital projects and local government improvements. They are backed by the full faith and credit of the Commonwealth and paid from the Governmental Funds, in which debt service principal and interest payments are appropriated. Massachusetts General Laws provide for the allocation of bond proceeds to these authorizations in arrears, as expenditures are made, unless the proceeds are allocated at the time of issuance.

College Opportunity Bonds - Some Commonwealth general obligation debt is issued as College Opportunity Bonds (COBs) as authorized by the Massachusetts General Laws. Such bonds were initially issued in fiscal year 1996, and have been issued in each subsequent fiscal year including fiscal year 2001 when approximately \$6,626,000 of such bonds was issued. Outstanding

COBs had maturity dates ranging from 2001 through 2020. COBs have an accreting interest component payable at maturity. The annual accretion rate of each COB's maturity is a variable rate equal to the change in annual Consumer Price Index (CPI) plus 2.0%. Assuming the CPI averages 3.5% during the life of the outstanding COBs the payments due at maturities of the COBs will total approximately \$172,177,000. In addition, COBs pay current interest in the amount of 0.5% per year of the initial amount still outstanding. The full faith and credit of the Commonwealth back these bonds. These bonds are sold to fund the Commonwealth's "U. Plan" which is part of a college savings program administered by the Massachusetts Educational Financing Authority. These bonds are privately placed and are structured to meet the needs of investors in this plan.

County Debt Assumed - Chapter 38 of the Acts of 1997 and Chapter 300 of the Acts of 1998 abolished several Massachusetts counties on various effective dates. As part of these provisions, the Commonwealth assumed the outstanding debt of Middlesex County on July 1, 1997, of Hampden and Worcester Counties on July 1, 1998 and that of Essex County on July 1, 1999 and that of Berkshire County on July 1, 2000. The county debt assumed has become general obligation debt of the Commonwealth. As of June 30, 2001, \$1,375,000 of these obligations remains outstanding.

Special Obligation Bonds - The Commonwealth also issues special obligation revenue bonds as authorized by Massachusetts General Laws. Such bonds may be secured by all or a portion of revenues credited to the Highway Fund and are not general obligations of the Commonwealth. At June 30, 2001, the Commonwealth had outstanding \$542,195,000 of such special obligation bonds, secured by a pledge of 6.86 cents of the 21.00-cent motor fuel excise tax imposed on gasoline. No new special obligation bonds were issued during the fiscal year.

Federal Highway Grant Anticipation Notes (GANS) - The Commonwealth also issues Federal Highway GANS to finance current cash flow for the Central Artery/Tunnel Project in anticipation of future federal reimbursements. Section 9 through 10D of Chapter 11 of the Acts of 1997, as amended by Chapter 121 of the Acts of 1998, authorizes the Commonwealth to sell up to \$1,500,000,000 in GANS. All Federal Highway Construction reimbursements and reimbursements from the federal highway construction trust funds are pledged to the repayment of the GANS. At June 30, 2001, the Commonwealth has \$1,499,325,000 of GANS outstanding, including accrued interest on capital appreciation bonds with maturity dates ranging from 2005 to 2015. These notes are secured by the pledge of Federal Highway Construction Reimbursements without a general obligation pledge. Under certain limited circumstances, a portion of the revenue from the Commonwealth's motor fuels excise tax may be used to pay debt service on the GANS.

Variable Rate Demand Bonds - Included in the long-term debt is \$1,542,600,000 of general obligation variable rate demand bonds (VRDBs) maturing from 2007 through 2030 in varying amounts. The redemption schedule for these bonds is included in the bond redemption schedule contained herein. The interest rate on the VRDBs is determined either weekly or daily based on the activity of the Commonwealth's remarketing agents, and interest is paid monthly. On any reset date holders of the VRDBs can require the Commonwealth (acting through its remarketing and tender agents) to repurchase the bonds (a "put"). The remarketing agent is authorized to use its best efforts to resell any repurchased bonds by adjusting the interest rates offered. The

Commonwealth pays an annual fee to the remarketing agents equal to 0.05% of the par amount of the bonds.

Under the provisions of stand-by bond-purchase agreements entered into by the Commonwealth with certain commercial banks, the remarketing and tender agents are entitled to draw amounts sufficient to pay the purchase price of any bonds that cannot be resold. During any such period the Commonwealth is required to pay the bank(s) at an interest rate based on their respective prime lending rates. If the remarketing agent is unable to resell any put bonds within six months of the put date, the stand-by bond-purchase agreements include provisions to convert any such bonds to installment loans payable over an extended period of time, with interest payable at a rate based on the bank(s) prime lending rate(s). The stand-by bond-purchase agreements expire on various dates between September of 2003 and February of 2006. The Commonwealth is required to renew or replace these agreements as long as the VRDBs remain outstanding. The Commonwealth currently pays an annual fee to maintain these agreements, which averages 0.124% of the par amount of the bonds.

As of June 30, 2001, \$1,267,000,000 of the VRDBs have been issued as general obligation refunding bonds. In connection with the issuance of such refunding bonds, the Commonwealth has entered into interest rate exchange ("swap") agreements with certain counterparties. These agreements require the counterparties to pay the Commonwealth an amount equal to the variable rate payable on the bonds and in return the Commonwealth pays a specified fix rate. Only the net difference in interest payments is exchanged with the counterparty. The Commonwealth continues to pay interest to the bondholders at the applicable variable rates. Through these agreements the Commonwealth has effectively fixed its interest rate payment obligations on the relevant VRDBs at rates ranging from 4.15% to 4.659%, not including the cost of liquidity and remarketing. The Commonwealth will be exposed to a variable rate if the counterparties default or if the swap is terminated. A termination of the swap may also result in the Commonwealth making or receiving a termination payment.

Auction Rate Securities – Also included in the long-term debt is \$401,500,000 of general obligation Auction Rate Securities (ARS) maturing in varying amounts from 2020 through 2030. The interest rate payable on the bonds changes weekly as determined pursuant to specified auction procedures. Interest on the bonds is payable weekly. In the case of a failed auction (i.e., insufficient bids to clear the market) existing buyers may be required to hold their bonds with interest payable at a rate equal to a percentage of an ARS industry index.

For financial reporting purposes, long-term debt is carried at its face value, which includes discount and any issuance costs. The outstanding amount represents the total principal to be repaid. For capital appreciation bonds, the outstanding amount represents total principal and accreted interest to be repaid. When short-term debt has been refinanced on a long-term basis, it is reported as outstanding at its face amount.

The amount of long-term debt authorized but unissued is measured in accordance with the statutory basis of accounting. Only the net proceeds (exclusive of discount and costs of issuance) are deducted from the total authorized by the Legislature.

Changes in long-term debt outstanding (including discount and issuance cost) and bonds authorized - unissued for the year ended June 30, 2001 are as follows (amounts in thousands):

	Bonds Outstanding	Authorized and Unissued
Balance July 1, 2000.....	\$ 12,383,101	\$ 11,585,706
General and special obligation bonds:		
Principal, less discount and issuance costs.....	1,768,815	(1,768,815)
Net premium and issuance costs.....	(16,617)	-
Grant Anticipation Notes:		
Principal, less discount and issuance costs	600,009	(600,009)
Premium and issuance costs.....	(22,404)	
Defeased Debt:		
Principal on Defeased Debt.....	(611,493)	-
Retired discount on Defeased Debt.....	(27,360)	-
General obligation refunding bonds:		
Principal on Refunding Bonds.....	964,645	
Principal on Refunded Bonds.....	(907,661)	
Retired discount on Refunded Bonds.....	(3,609)	
Increase in bonds authorized.....	-	282,345
Contributions in lieu of bonds.....	-	41
Bonds retired.....	(127,972)	-
Deauthorized.....	-	(136,778)
Reversions.....	-	(72,072)
Balance June 30, 2001.....	<u>\$ 13,999,454</u>	<u>\$ 9,290,418</u>

Business Type Activities - Colleges and University Debt— Building authorities related to the University of Massachusetts and the state colleges have issued bonds for construction of higher education facilities and equipment. Such bonds are guaranteed by the Commonwealth in an aggregate amount not to exceed \$278,000,000. The bond agreements generally provide that revenues from student fees are pledged as collateral on the bonds and establish bond reserve funds, bond funds, and maintenance reserve funds. The University of Massachusetts and state colleges have also entered into various loan agreements as participants in the Massachusetts Health and Educational Facilities Authority's (MHEFA) ongoing capital asset program to finance construction projects and equipment.

At June 30, 2001, debt service requirements to maturity for principal (including discount, capital appreciation and issuance costs) and interest are as follows for both governmental and business-type activities (amounts in thousands):

Fiscal Year Ended June 30,	<u>Governmental Activities</u>		<u>Business - Type Activities</u>	
	<u>General Obligation</u>		<u>College and University Revenue</u>	
	<u>Principal</u>	<u>Interest</u>	<u>Principal</u>	<u>Interest</u>
2002	\$ 699,441	\$ 691,869	\$ 16,677	\$ 38,712
2003	751,941	653,439	33,668	37,936
2004	734,485	620,897	27,272	36,353
2005	796,597	588,028	21,559	34,816
2006	903,532	547,136	22,442	33,645
2007-2011	4,669,802	2,025,652	124,466	146,536
2012-2016	3,419,866	903,481	169,874	105,149
2017-2021	1,400,732	317,915	129,861	95,013
2022-2026	214,604	137,761	88,804	74,231
2027-2031	408,455	55,245	100,045	38,805
2032-2036	-	-	16,581	3,531
2037-2041	-	-	5,200	569
Total	<u>\$ 13,999,454</u>	<u>\$ 6,541,423</u>	<u>\$ 756,450</u>	<u>\$ 645,295</u>

The above schedule assumes the variable rate to be paid at 5%.

The Commonwealth issued bonds and notes through both competitive and negotiated sales during fiscal year 2001. The costs for legal counsel and underwriting fees (including estimated amounts related to competitive sales) for bond sales were \$739,569 and \$11,261,499 respectively. In addition, the Commonwealth paid \$80,000 for disclosure counsel services.

Bonds Defeased Through Refunding – As authorized by the Massachusetts General Laws, the Commonwealth advance refunded certain general obligation bonds through the issuance of \$964,645,000 of general obligation refunding bonds during fiscal year 2001. Net proceeds totaling approximately \$994,347,000 were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased, and the liabilities therefore have been removed from the General Long-term Obligations Account Group. As a result of this refunding, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$39,640,000 over the next 20 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$41,875,000. At June 30, 2001, approximately \$911,270,000 of the bonds refunded remain outstanding and are defeased.

In August 2001, the Commonwealth refunded additional general obligation bonds through the issuance of \$596,745,000 of general obligation refunding bonds. Net proceeds totaling approximately \$629,240,000 were used to purchase U. S. Government securities which were deposited in irrevocable trusts with an escrow agent to provide for all future debt service payments of the refunded bonds. As a result, the refunded bonds are considered to be defeased as of the date of the refunding and the liabilities therefore will be removed from the General Long-term Obligations Account Group in fiscal year 2002. As a result of this refunding, the Commonwealth decreased current year debt service payments and has taken advantage of lower interest rates, and it has decreased its aggregate debt service payments by approximately \$30,145,000 over the next 12 years and will experience an economic gain (the difference between the present values of the debt service payments of the refunded and refunding bonds) of approximately \$23,932,000.

Bonds Defeased Through Operating Surplus – At the end of fiscal year 2000, pursuant to the provisions of Chapter 87 of the Acts of 2000, the Commonwealth set aside \$650,000,000 of surplus funds in the debt defeasance fund to defease additional debt of the Commonwealth. \$500,000,000 of the funds were attributable to fiscal year 2000 and \$150,000,000 were from prior fiscal years. In July, August and December of 2000, the State Treasurer expended a combined total of \$650,037,000 from the Debt Defeasance Trust Fund to purchase securities and establish a sinking fund to provide for the payment of certain Commonwealth general obligation bonds maturing on August 1, 2000 through and including July 1, 2001. The securities purchased consisted of U.S. Government securities and certain obligations issued by federal agencies, all of which are being held by a third-party trustee in an irrevocable trust. The approximate principal amount of Commonwealth general obligation bonds defeased pursuant to these transactions is \$638,853,000, including \$32,810,000 of bonds maturing on July 1, 2001. The amount that would have been expended for debt service on such bonds in fiscal 2001 (approximately \$624,589,000) was deposited in the Central Artery and Statewide Road and Bridge Infrastructure Fund, pursuant to the provisions of the act. An additional \$34,589,000, related to the defeased bonds maturing on July 1, 2001 was deposited in this fund on that date.

Prior Defeasance - In prior years, the Commonwealth defeased certain general and special obligation bonds by purchasing securities (from the proceeds of refunding bonds or from surplus operating funds) and placing them in irrevocable trusts to provide for all future debt service payments on the defeased bonds. Accordingly, the trust account assets and the liabilities for the defeased bonds are not included in the financial statements. At June 30, 2001, approximately \$2,128,782,000 of bonds outstanding from activities in prior fiscal years are considered defeased.

Bond Issuances Subsequent to June 30, 2001

The following bond series' were issued subsequent to June 30, 2001, but before the date of the audit opinion:

<u>Description</u>	<u>Issue Size</u>	<u>Refunding Portion</u>	<u>Interest Rate Range (%)</u>	<u>FY of Maturities</u>
General Obligation Bonds Consolidated Loan of 2001, Series C	\$ 935,530	\$ 596,745	2.4-5.125	2002-2022
General Obligation Bonds Consolidated Loan of 2001, Series D	823,845	585,785	3-6	2004-2022
College Opportunity Bonds - Series 2001	5,636	-	Variable	2006-2021
General Obligation Bond Anticipation Notes 2001, Series A	350,000	-	4	2004

Major Discretely Presented Component Units

Massachusetts Water Pollution Abatement Trust, Pool Loan Program Bonds, Series 7	321,805	207,206	3-5.25	2002-2031
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Minor Discretely Presented Component Units

Various Regional Transit Authorities - Revenue Anticipation Notes	45,657		3-3.65	2002
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Statutory Debt Limit – The Massachusetts General Laws establish limits on the amount of governmental direct debt outstanding. By statutorily limiting the Commonwealth's ability to issue direct debt, this limit provides a control on annual capital spending. The direct debt limit for fiscal year 2001 was approximately \$11,076,483,000. Outstanding governmental debt subject to the limit at June 30, 2001 was approximately \$10,279,959,000. The limit increases 5% per year.

For purposes of determining compliance with the limit, outstanding direct debt is defined to include general obligation bonds and minibonds at the amount of their original net proceeds. It excludes BANs and discount and issuance costs, if any, financed by these bonds. It also excludes special obligation bonds, GANs, refunded bonds, certain refunding bonds, debt issued by counties, and debt issued in conjunction with the MBTA forward funding.

The amounts excluded from the governmental debt limit are as follows (amounts in thousands):

	<u>Debt Outstanding</u>
Balance June 30, 2001.....	\$ 13,999,454
Less amounts excluded:	
Discount and issuance cost.....	(282,829)
Chapter 5 of the Acts of 1992 Refunding...	(71,054)
Special Obligation Principal.....	(539,242)
GANs Principal.....	(1,500,000)
County Debt Assumed.....	(1,375)
MBTA Forward Funding.....	(325,000)
Central Artery Tunnel.....	(999,995)
Outstanding Direct Debt.....	<u>\$ 10,279,959</u>

Other long -term liabilities will be liquidated in the future from governmental funds. During the year ended June 30, 2001, the following changes occurred in liabilities reported as part of the long term liabilities in the statement of net assets (amounts in thousands)

Governmental Activities	Interest Rates	Maturity Through	Balance as of July 1, 2000	Additions	Reductions / Retirements	Balance as of June 30, 2001
Bonds Payable:						
General Obligation Debt	0.00 - 8.00%	2031	\$ 10,562,837	\$ 2,734,241	\$ 1,619,695	\$ 11,677,383
Special Obligation Debt	4.30 - 7.00%	2017	561,335	-	22,093	539,242
Grant Anticipation Notes	0.00 - 7.00%	2015	899,991	600,009	-	1,500,000
Unamortized (Premiums) / Discounts:						
General Obligation Debt			334,059	22,601	76,109	280,551
Special Obligation Debt			3,150	-	197	2,953
Grant Anticipation Notes			21,729	-	22,404	(675)
Total Bonds Payable			\$ 12,383,101	\$ 3,356,850	\$ 1,740,497	\$ 13,999,454
Other Long Term Liabilities:						
Compensated Absences			\$ 146,473	\$ 7,716	\$ -	\$ 154,192
Prizes Payable			6,409	4,092	-	10,501
Claims and Judgements			134,800	-	21,800	113,000
Capital Lease Obligations			53,459	38,849	-	92,308
School Construction Grants Payable			4,746,571	667,654	-	5,414,225
Total Other Long - Term Liabilities			\$ 5,087,712	\$ 718,311	\$ 21,800	\$ 5,784,226
Total Long - Term Liabilities			\$ 17,470,813	\$ 4,075,161	\$ 1,762,297	\$ 19,783,680
Business - Type Activities						
Bonds Payable:						
Revenue Obligation Debt	3.00 - 12.00%	2034	\$ 507,904	\$ 248,546	\$ -	\$ 756,450
Other Long Term Liabilities:						
Compensated Absences			\$ 114,832	\$ 11,948	\$ -	\$ 126,780
Capital Lease Obligations			75,031	14,363	-	89,394
Total Other Long - Term Liabilities			\$ 189,863	\$ 26,311	\$ -	\$ 216,174
Total Long - Term Liabilities			\$ 697,767	\$ 274,857	\$ -	\$ 972,624

Discretely Presented Component Units – Bonds and notes outstanding at June 30, 2001 (December 31, 2000 for Massachusetts Turnpike Authority), net of unamortized discount of approximately \$183,415,000 and unamortized loss on refunding of approximately \$65,617,000, are as follows (amounts in thousands):

	Interest Rates	Maturity Through	Balance as of July 1, 2000	Additions	Reductions/ Retirements	Balance as of June 30, 2001
Major Component units:						
Massachusetts Bay Transportation Authority						
General Transportation System	3.85 - 7.00	2007-2030	\$ 3,427,608		\$ 63,156	\$ 3,364,452
Boston Metropolitan District	5.00 - 6.00	2002-2014	33,471		2,646	30,825
Revenue Bonds	4.40 - 5.75	2030	-	600,000	-	600,000
			<u>3,461,079</u>	<u>600,000</u>	<u>65,802</u>	<u>3,995,277</u>
Massachusetts Turnpike Authority						
Revenue Serial Bonds	3.90 - 5.65	2004-2039	2,426,628	4,366	-	2,430,994
Massachusetts Water Pollution Abatement Trust						
MWPAT Revenue Bonds	4.00 - 6.375	2000-2030	868,141	341,430	43,506	1,166,065
Subordinated Revenue Refunding	4.00 - 6.00	2000-2029	528,595		16,950	511,645
			<u>1,396,736</u>	<u>341,430</u>	<u>60,456</u>	<u>1,677,710</u>
NonMajor Component Units						
Notes payable	1.00 - 9.18	2001-2013	136,406	31,130	12,936	154,600
Current interest serial bonds	4.40 - 5.575	2001-2025	13,573	191,615	1,223	203,965
Compound interest serial bonds	5.25 - 6.80	2001-2033	58,214	198,018	12,972	243,260
Electric System Utility bonds (Devens)	5.13 - 6.00	2011-2030	-	10,640	-	10,640
Devens projects bonds	Weighted Avg 6.31	2007	-	63,521	465	63,056
Revenue bonds payable		2040	185,594	-	3,296	182,298
			<u>393,787</u>	<u>494,924</u>	<u>30,892</u>	<u>857,819</u>
Total			\$ 7,678,230	\$ 1,440,720	\$ 157,150	\$ 8,961,800

The amounts below represent the face amounts of bonds and notes outstanding and may differ from the amounts included in the combined balance sheet due to treatment of original issue discount in the general-purpose financial statements. Maturities of principal are as follows (amounts in thousands):

Years Ending June 30,	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Massachusetts Water Pollution Abatement Trust	NonMajor Component Units	Total
	Authority	Authority	Trust	Units	
2002	\$ 115,804	\$ 7,945	\$ 65,935	\$ 55,756	\$ 245,440
2003	124,081	12,295	68,625	30,780	235,781
2004	127,915	13,050	70,020	32,941	243,926
2005	135,420	39,935	71,425	36,431	283,211
2006	147,330	19,535	71,795	33,091	271,751
2007 - 2011	755,905	2,456,268	389,525	544,337	4,146,035
2012 - 2016	813,590		395,115	47,600	1,256,305
2017 - 2021	790,930		303,260	23,713	1,117,903
2022 - 2026	730,860		165,460	21,860	918,180
2027 - 2031	384,440		76,550	17,085	478,075
2032 - 2036	-		-	12,470	12,470
2037 - 2040	-		-	6,815	6,815
	<u>\$ 4,126,275</u>	<u>\$ 2,549,028</u>	<u>\$ 1,677,710</u>	<u>\$ 862,879</u>	<u>\$ 9,215,892</u>

The MBTA issued certificates of participation in the amounts of approximately \$28,565,000 on December 15, 1988 and approximately \$85,795,000 on August 30, 1990 to finance the purchase of commuter rail coaches. Under the terms of the applicable agreements, the MBTA's obligation to make the annual payments on the certificates is subject to the Commonwealth's appropriation of necessary funds in its annual budget.

The certificates bear interest at rates ranging from 7.30% to 7.80% and mature as follows (amounts in thousands):

Years Ending June 30,	Amount
2002.....	\$ 1,150
2003.....	1,140
2004.....	1,140
2005.....	1,140
2006.....	1,135
2007 - 2011.....	1,135
	<u>\$ 6,840</u>

On February 22, 1995, Pioneer Valley Transit Authority (PVRTA) issued certificates of participation of approximately \$9,930,000 to finance the purchase of buses. Under the terms of the agreement, PVRTA is obligated to make annual payments on the certificates subject to the Commonwealth appropriated the necessary funds in the Authority's annual budget. As of June 30, 2001, the principal amount of certificates outstanding is \$2,468,000.

In prior years, the MBTA defeased in-substance several General Transportation System Bonds by placing the proceeds of new bonds in an irrevocable trust fund to provide for future debt service payments on the old debt. Accordingly, the trust account asset and the liability for the defeased bonds are not included in the

accompanying financial statements. On June 30, 2001, approximately \$1,943,220,000 of these bonds outstanding are considered defeased.

Massachusetts Bay Transportation Authority – In August 2001, the Massachusetts Bay Transportation Authority defeased \$117,975,000 of General Transportation System Bonds by placing \$122,680,000 of proceeds from the assessment bonds in an irrevocable trust fund to provide for future debt service payments on the old debt.

9. INDIVIDUAL FUND DEFICITS

Certain funds within the Governmental Fund Type and Proprietary Fund Type have fund deficits at June 30, 2001 as follows (amounts in thousands):

<u>Fund</u>	<u>Amount</u>
Special Revenue:	
Federal Grants.....	\$ 6,245
Highway.....	265,289
Environmental.....	53,914
Lotteries.....	13,017
Capital Projects:	
General Capital Projects.....	107,117
Convention and Exhibition Center.....	154,832
Capital Expenditure Reserve.....	143,427
Highway.....	849,605
Federal Highway Construction.....	280
Government Land Bank.....	6,300
Intercity Bus.....	3,531
Local Aid.....	3,823
Internal Service Funds:	
Employees Workers' Compensation.....	240,960
Employees Group Health Insurance	7,922

The Environmental Fund has incurred a deficit primarily due to increased state funding for clean up of hazardous waste for the Environmental Permitting and Compliance Fund. The revenues allocated to this fund have not been sufficient to support the increased spending. The Commonwealth will budget in future years the allocation of revenue to support the increased spending authority.

Deficits in the Capital Projects Funds reflect the time lag between capital expenditures and the receipt or allocation of proceeds from the sale of related bonds and the amortization of the net cost of forward funding the MBTA.

The deficit in the Internal Service Fund reflects the accruals for workers' compensation and group insurance claims of \$248,882,000. Funding of these deficits is dependent upon legislative actions to develop an actuarial funding plan.

10. RETIREMENT SYSTEMS

Primary Government – The Commonwealth is statutorily responsible for the pension benefits for Commonwealth employees (members of the State Employees' Retirement System) and for teachers of the cities, towns, regional school districts throughout the Commonwealth and Quincy College (members of the Teachers' Retirement System, except for teachers in the Boston public schools, who are members of the State-Boston Retirement System but whose pensions are also the responsibility of the Commonwealth). The members of the retirement systems do not participate in the Social Security System.

The Commonwealth has assumed responsibility for payment of cost-of-living adjustments (COLA) for the separate (non-teacher) retirement systems of its cities, towns and counties, granted in fiscal year 1997 and prior. The Commonwealth is statutorily required to have an actuarial valuation once every three years and every two years on a GAAP basis.

Certain Commonwealth employees and current retirees employed prior to the establishment of the State Employees' Retirement System are covered on a "pay-as-you-go" basis. During the year ended June 30, 2001, the Commonwealth's pension expenditure included payments totaling \$18,072,000 to current retirees employed prior to the establishment of the current plans and the non-contributory plans.

Plan Descriptions –

State Employees' Retirement System (SERS) is a single employer defined benefit public employee retirement system (PERS), covering substantially all employees of the Commonwealth and certain employees of the independent authorities and agencies, including the state police officers at the Massachusetts Port Authority and the Massachusetts Turnpike Authority. The SERS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand alone financial report.

Teachers' Retirement System (TRS) is an agent multiple employer defined benefit PERS. The Commonwealth is a non-employer contributor and is responsible for all contributions and future benefit requirements of the TRS.

The TRS covers certified teachers in cities (except the City of Boston), towns, regional school districts and Quincy College. The TRS is administered by the Commonwealth and is part of the reporting entity and does not issue a stand-alone financial report.

State – Boston Retirement System (SBRs) is hybrid multiple employer defined benefit PERS. SBRs provides pension benefits to all full-time employees upon commencement of employment with any of the various government agencies covered by SBRs. The Commonwealth is a non-employer contributor and is only responsible for the actual cost of pension benefits for SBRs participants who serve in the City of Boston's School Department in a teaching capacity. The cost of pension benefits of the other participants is the responsibility of the City of Boston. SBRs is not administered by the Commonwealth and is not part of the reporting entity and a stand-alone financial report is not available. The policy for postretirement benefit increases for all retirees of the SERS, TRS, SBRs and COLA of local governments is subject to legislative approval.

Membership – Membership in SERS, TRS and SBRs as of January 1, 2001, the date of the most recent valuation, is as follows:

	<u>SERS</u>	<u>TRS</u>	<u>SBRs</u>
Retirees and beneficiaries			
currently receiving benefits.....	44,027	32,631	2,426
Terminated employees entitled to benefits but not yet receiving them.....	<u>2,775</u>	<u>-</u>	<u>115</u>
Subtotal.....	<u>46,802</u>	<u>32,631</u>	<u>2,541</u>
Current employees:			
Vested.....	41,250	37,868	1,586
Non-vested.....	<u>45,868</u>	<u>48,930</u>	<u>3,985</u>
Subtotal.....	<u>87,118</u>	<u>86,798</u>	<u>5,571</u>
Total.....	<u><u>133,920</u></u>	<u><u>119,429</u></u>	<u><u>8,112</u></u>

Benefit Provisions – Massachusetts General Laws established uniform benefit and contribution requirements for all contributory PERS. These requirements provide for retirement allowance benefits up to a maximum of 80% of a member's highest three-year average annual rate of regular compensation. Benefit payments are based upon a member's age, length of creditable service, and group classification. The authority for amending these provisions is with the Legislature.

Members become vested after ten years of creditable service. A superannuation retirement allowance may be received upon the completion of twenty years of service or upon reaching the age of 55 with ten years of service. Normal retirement for most employees occurs at age 65; for certain hazardous duty and public safety positions, normal retirement is at age 55.

During fiscal year 2001, the legislature passed Chapter 114 of the Acts of 2000, which modified Chapter 32 of the General Laws. This modification became effective on July 1, 2001. In Chapter 114, teachers who are members of the State Teachers Retirement System, or teachers who are members of the State – Boston retirement system before 1975, who resigned or took an unpaid leave of absence because of maternity leave will be allowed to "buy back" into the fund

up to a maximum of four years. The member must pay the amount determined by the retirement board by December 31, 2001 to qualify, as long as the member has worked longer than ten years. If the member completes ten years of service after December 31, 2001, payment can be made within 18 months of completion of ten years of service. In addition, the law creates a superannuation retirement benefit program for all teachers hired on or after July 1, 2001. This program has a contribution rate of 11 percent of regular compensation. To be eligible for the alternative benefit at retirement, the teacher must have completed thirty years of eligible service. All previous members may elect to participate in the program, as long as they participate with the equivalent of a minimum of five years of employee contributions at the new rate. If the member retires before five years, the teacher must pay into the system, the amount that would have been paid in one lump sum, or in installments as the Board may prescribe. The alternative benefit is calculated as the percentage of average compensation determined under the current formula increased by 2% of the average annual compensation for each full year of service in excess of 24 years. The election to participate is irrevocable.

Funding Progress – The SERS, TRS and SBRS actuarial determined contributions were computed as part of the actuarial valuation as of January 1, 2001. The Commonwealth has revised actuarial assumptions used in the calculation of contribution requirements and Unfunded Actuarial Liability (UAL.) The revised actuarial assumptions are the result of an experience study commissioned by the Commonwealth for the period 1996 to 1999 concluded in fiscal year 2001. The Commonwealth has fully phased-in its UAL from a market value of assets to an actuarial valuation of assets. In the third year of transition as of January 1, 2001 the calculated actuarial value of assets was 97% of the market value compared to 91% in the 2000 valuation and 97% in the 1998 valuation.

A significant change in assumption as of the January 1, 2001 valuation, that resulted from the experience study, was to modify projected salary increase percentage to reflect different groups of employees and years of service. The applicable annual rate in the current valuation range from 4.75% to 12% compared to the prior actuarial assumption of a single rate of 6%.

Other significant assumptions include (a) cost of living (inflation rate) increases of 3% per year on the first \$12,000 of the retirees total allowance, and (b) interest rate credited to the annuity savings fund of 4.5% per year. These calculations use a level dollar amortization method over 20-years closed period.

The following table presents the schedule of funding progress as presented in the six most recent actuarial valuations at the date indicated (amounts in thousands):

Actuarial Valuation as of January 1	Actuarial Value of Plan Assets	Actuarial Accrued Liability	Unfunded Actuarial Liability (UAL)	Funded Ratio %	Annual Covered Payroll *	UAL as a % of Covered Payroll
State Employees' Retirement System						
2001	\$ 13,922,000	\$ 15,170,000	\$ 1,248,000	91.8 %	\$ 3,700,000	33.7 %
2000	13,364,000	14,138,000	773,000	94.5	3,472,000	22.3
1998	9,914,000	11,361,000	1,447,000	87.3	3,111,000	46.5
1996	7,366,000	9,441,000	2,075,000	78.0	2,989,000	69.4
1995	5,879,000	8,602,000	2,723,000	68.3	2,992,000	91.0
1993	5,071,000	8,738,000	3,667,000	58.0	2,919,000	125.6
1992	4,699,000	7,303,000	2,604,000	64.3	2,638,000	98.7
Teachers' Retirement System						
2001	14,390,000	18,170,000	3,779,000	79.2	4,072,000	92.8
2000	13,681,000	16,420,000	2,739,000	83.3	3,704,000	73.9
1998	10,170,000	13,095,000	2,925,000	77.7	3,175,000	92.1
1996	7,553,000	10,252,000	2,699,000	73.7	2,810,000	96.0
1995	6,014,000	9,712,000	3,698,000	61.9	2,667,000	138.7
1993	5,142,000	8,921,000	3,779,000	57.6	2,428,000	155.6
1992	4,784,000	8,706,000	3,922,000	55.0	2,032,000	193.0
State - Boston Retirement System (Boston Teachers)						
2001	918,000	1,502,000	583,000	61.1	304,000	191.8
2000	860,000	1,381,000	521,000	62.3	285,000	182.8
1998	699,000	1,219,000	520,000	57.3	285,000	182.5
1996	549,000	1,025,000	476,000	53.6	274,000	173.7
1995	438,000	833,000	395,000	52.6	232,000	170.3
1993	370,000	743,000	373,000	49.8	206,000	181.1
1992	342,000	759,000	417,000	45.1	184,000	226.6

* - The covered payroll amounts approximate the employer payroll.

Pension Actuarial Valuation – The Commonwealth's pension actuarial valuation was performed as of January 1, 2001 pursuant to Chapter 32 of the General Laws of the Commonwealth of Massachusetts and based on the plan provisions at that time.

The Commonwealth was financially responsible for the COLA granted to participants in the 104 retirement systems of cities, towns and counties in fiscal year 1997 and prior fiscal years. Chapter 17 of the Acts of 1997 effective for fiscal year 1998 transferred the responsibility for funding COLAs for separate (non-teacher) retirement systems of cities and towns to the respective system. Any future COLA granted by the Legislature to employees of these plans will be the responsibility of the individual system. The individual employer governments are also responsible for the basic pension benefits. The retirement systems are not administered by the Commonwealth and are not part of the reporting entity. The actuarial accrued liability for COLA as of January 1, 2001 was \$764,000,000.

Contributions Required and Contributions Made – The retirement systems' funding policies have been established by Chapter 32 of the Massachusetts General Laws. The Legislature has the authority to amend these policies. The annuity portion of the SERS, TRS and SBRS retirement allowance is funded by employees, who contribute a percentage of their regular compensation – 5% for those hired before January 1, 1975, 7% for those hired from January 1, 1975, through December 31, 1983 and 8% for those hired on or after January 1, 1984, plus an additional 2% of compensation above \$30,000 per year for those hired

on or after January 1, 1979. Regular employees and state police hired after June 30, 1996 are required to contribute 9% and 12% respectively of their regular compensation plus an additional 2% of compensation above \$30,000 per year. Costs of administering the plan are funded out of plan assets.

The Commonwealth's contribution for the pension benefit portion of the retirement allowance of SERS and TRS and required payments to cover SBRS and COLA contributions were originally established on a "pay-as-you-go" basis. As a result, amounts were appropriated each year to pay current benefits, without a systematic provision to fully fund future liabilities already incurred. Beginning in fiscal year 1988, the Commonwealth enacted the Pension Reform Act of 1987 and addressed the unfunded liability of SERS, TRS and its participation in SBRS and its COLA obligation. Chapter 32, Section 22C of General Laws enacted in 1998 calls for the payment of normal cost plus an amortization payment of UAL such that the UAL is reduced to zero by June 30, 2018.

This legislation also directs the Secretary of Administration and Finance to prepare a funding schedule to meet these requirements, and to update this funding schedule every three years on the basis of new actuarial valuation reports prepared under the Secretary's direction. Any such schedule is subject to legislative approval. If a schedule is not so approved, payments are to be made in accordance with the most recently approved schedule. The current legislatively approved funding schedule, a valuation as of January 1, 1999, was filed by the Secretary of Administration and Finance on March 1, 2000 has been deemed approved by the Legislature. Under the current schedule the amortization payments are designed to eliminate the unfunded liability by fiscal year 2018. Based on the previous funding schedule required contributions by the Commonwealth of \$1,022,050,000 were made during the fiscal year ended June 30, 2001.

Of this amount \$43,048,000 represents payments for COLA granted to participants in retirement systems of cities, towns and counties. GAAP requires that pension expenditures (costs) be based on an acceptable actuarial cost method and that they be not less than:

- Normal cost plus amortization of net pension obligation cost
- Interest and amortization on any unfunded prior service costs

The funding schedule discussed above follows an acceptable actuarial funding methodology to compute normal cost and the unfunded accrued actuarial liability.

No accrual is required for pension contribution on the Balance Sheet as the Commonwealth has contributed over 100% of its Annual Required Contribution (ARC).

The following table presents the schedule of employer contributions (amounts in thousands):

Actuarial Valuation as of January 1	Annual Required Contribution (ARC)	Interest on NPO	Amortization of NPO	Pension Cost	Actual Contribution Made	Net Pension (Obligation) Asset (NPO)	% of ARC Contributed	% of Pension Cost Contributed
State Employees' Retirement System								
2001	\$ 275,204	\$(109,731)	\$ (133,387)	\$ 298,861	\$ 320,381	\$ 1,351,592	116 %	107 %
2000	352,084	(108,400)	107,190	350,873	367,000	1,330,071	104	105
1999	319,454	(103,188)	98,556	314,822	378,000	1,313,944	118	120
1998	261,255	(83,446)	77,180	254,989	494,289	1,250,766	189	194
1997	246,037	(65,478)	41,889	222,448	463,590	1,011,466	188	208
1996	232,158	(46,918)	29,523	214,763	433,114	770,324	187	202
1995	249,640	(31,639)	19,614	237,615	417,361	551,973	167	176
1994	266,564	(18,448)	9,152	257,268	398,900	372,227	150	155
1993	243,587	(5,539)	2,694	240,742	402,100	230,595	165	167
1992	252,687	136	(65)	252,758	323,700	69,237	128	128
Teachers' Retirement System								
2001	475,053	(78,498)	(95,421)	491,976	539,000	998,513	113	110
2000	480,873	(79,487)	78,599	479,985	468,000	951,489	97	98
1999	373,777	(70,312)	67,155	370,620	481,826	963,474	129	130
1998	315,474	(59,126)	54,686	311,034	446,619	852,267	142	144
1997	245,426	(44,832)	28,681	229,275	418,519	716,682	171	183
1996	232,403	(30,311)	19,073	221,165	392,003	527,439	169	177
1995	277,343	(24,002)	14,880	268,221	342,441	356,601	123	128
1994	247,460	(15,975)	7,925	239,410	322,100	282,381	130	135
1993	225,838	(9,946)	4,837	220,729	296,100	199,691	131	134
1992	223,041	(4,996)	2,384	220,429	282,300	124,320	127	128
State-Boston Retirement System								
2001	66,820	1,542	1,875	66,488	86,000	815	129	129
2000	58,266	448	(443)	58,271	45,000	18,697	77	77
1999	53,453	(989)	944	53,409	36,000	5,426	67	67
1998	48,795	(2,114)	1,995	48,636	35,000	11,983	72	72
1997	34,621	(2,082)	1,332	33,871	35,000	25,619	101	103
1996	32,908	(1,860)	1,171	32,219	34,822	24,490	106	108
1995	28,168	(1,816)	1,126	27,478	28,000	21,887	99	102
1994	22,448	(1,216)	603	21,835	28,000	21,365	125	128
1993	20,463	(650)	316	20,129	27,200	15,200	133	135
1992	26,530	(634)	303	26,199	26,400	8,129	100	101

The total contributions required for SERS, TRS and SBRS are based on the entry age normal cost method using the same actuarial assumptions used to compute the net pension obligation.

Post-retirement Health Care and Life Insurance Benefits – In addition to providing pension benefits, under Chapter 32A of the Massachusetts General Laws, the Commonwealth is required to provide certain health care and life insurance benefits for retired employees of the Commonwealth, housing authorities, redevelopment authorities, and certain other governmental agencies. Substantially all of the Commonwealth's employees may become eligible for these benefits if they reach retirement age while working for the Commonwealth. Eligible retirees are required to contribute a specified percentage of the health care benefit costs that is comparable to contributions required from employees. The Commonwealth is reimbursed for the cost of benefits to retirees of the eligible authorities and non-state agencies. The Commonwealth recognizes its share of the costs of providing these benefits when paid. These payments totaled approximately \$209,643,000 for the fiscal year ended June 30, 2001. There are approximately 46,000 participants eligible to receive benefits at June 30, 2001.

11. DEFERRED COMPENSATION PLAN

The Commonwealth offers its employees a deferred compensation plan created in accordance with Internal Revenue Code (IRC) Section 457. The plan, available to all employees of the Commonwealth and its political subdivisions, permits them to defer a portion of their salaries until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the employee. Participants' rights under the plan are equal to the fair value of the deferred account for each participant. All plan assets are stated at fair value. It is the opinion of the Commonwealth that it has no liability for losses under the plan, but it does have the duty of due care which would be required of an ordinary prudent investor.

Accordingly, the Plan-Trust Declaration has been prepared such that the plan's assets are held in trust, and reported as an expendable trust fund, for the exclusive benefit of participants and their beneficiaries.

The deferred compensation trust fund uses the calendar year for its fiscal reporting cycle. Certain amounts recorded as agency activity in the discretely presented components are held in trust by the Commonwealth.

The Treasurer and Receiver General (Treasurer) of the Commonwealth of Massachusetts is the plan trustee. Per statute, the Treasurer is given authority, on behalf of the Commonwealth, to contract with state employees to defer a portion of those employees' compensation, and for the purposes of funding a deferred compensation program for the said employees to invest the deferred portion of the employees' income.

12. LEASES

Primary Government – Governmental Activities

In order to finance the acquisition of equipment, the Commonwealth has entered into various lease/purchase agreements, including tax-exempt lease purchase (TELP) agreements, which are accounted for as capital leases. Lease agreements are for various terms and contain clauses indicating that their continuation is subject to appropriation by the Legislature. For the fiscal year ended June 30, 2001, capital lease/purchase expenditures totaled approximately \$37,775,000. At June 30, 2001, the Commonwealth's aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totals approximately \$92,308,000. This liability is reported as a Long-Term obligation in both the governmental and business-type activities. Equipment acquired under capital leases and included as fixed assets totaled approximately \$112,432,000.

The Commonwealth has numerous operating lease agreements for real property and equipment with varying terms. These agreements contain provisions indicating that continuation is subject to appropriation by the Legislature. Operating lease expenditures for the fiscal year ended June 30, 2001 was approximately \$168,479,000.

Business Type Activities – University and Colleges information – At June 30, 2001, aggregate outstanding liability under capital leases, the present value of the net minimum lease payments, totaled approximately \$92,308,000. Equipment acquired under capital leases is included in University and College Fund fixed assets.

The Colleges and the University leases real property and equipment under numerous operating lease agreements for varying terms. Rental expenditures for the fiscal year ended June 30, 2001 were approximately \$15,479,000.

The following schedule summarizes future minimum payments under non-cancelable leases for Governmental activities and for the Colleges and University – reported as a business-type activity, for the fiscal year ended June 30, 2001 (amounts in thousands):

	Governmental Activities				Business - Type Activities Colleges and University			
	Capital Leases		Operating Leases	Total	Capital Leases		Operating Leases	Total
	Principal	Interest			Principal	Interest		
2002	\$ 21,901	\$ 1,847	\$ 121,392	\$ 145,140	\$ 19,472	\$ 3,128	\$ 13,853	\$ 36,453
2003	17,783	1,605	97,991	117,379	15,733	2,806	11,871	30,410
2004	14,789	1,486	70,870	87,145	13,282	2,296	9,363	24,941
2005	13,076	1,361	47,687	62,124	10,247	1,713	7,991	19,952
2006	8,614	1,272	20,842	30,728	7,883	1,569	5,079	14,531
2007-2011	16,146	2,454	68,336	86,935	22,322	5,373	9,921	37,615
2012-2016	-	-	-	-	281	68	1,278	1,626
2017-2021	-	-	-	-	174	42	762	978
Total	<u>\$ 89,603</u>	<u>\$ 12,730</u>	<u>\$ 427,118</u>	<u>\$ 529,451</u>	<u>\$ 89,394</u>	<u>\$ 16,995</u>	<u>\$ 60,118</u>	<u>\$ 166,506</u>

Discretely Presented Component Units –

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of net minimum lease payments as of June 30, 2001 (amounts in thousands):

Years Ending June 30,	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Massachusetts Water Pollution Abatement Trust	NonMajor Component Units	Total
2002	\$ 43,825	\$ -	\$ -	\$ 736	\$ 44,561
2003	46,773	-	-	716	47,489
2004	48,380	-	-	716	49,096
2005	41,140	-	-	717	41,857
2006	42,097	-	-	714	42,811
2007 - 2011	248,903	-	-	711	249,614
2012 - 2016	314,552	-	-	-	314,552
2017 - 2021	89,359	-	-	-	89,359
Total payments	875,029	-	-	4,310	879,339
Less: interest	(326,299)	-	-	(667)	(326,966)
Present value of net minimum lease payments	<u>\$ 548,730</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 3,643</u>	<u>\$ 552,373</u>

The MBTA has entered into several sale-leaseback agreements with major financial institutions, covering equipment and rolling stock, which has been accounted for as operating leases. These leases expire through fiscal year 2013. Upon termination, the MBTA may purchase the equipment and rolling stock at

prices equal to the lesser of a stated percentage (40%-70%) of the lessor's original purchase price or residual fair market value, as defined.

The MTA has operating leases for administrative office space and automatic toll collection equipment. These operating leases expire on various dates through June 2004. Lease expenses charged to the Massachusetts Turnpike and Sumner-Callahan-Williams Tunnels were approximately \$1,058,000 of which \$925,000 was paid to the Commonwealth for office space in a state-owned building.

The MTA leases property and air rights to others. The MTA earned approximately \$11,351,000 in rental income. Rental income for the next five years is expected to approximate \$8,693,000 per year based on leases currently in effect.

The Economic Development Entities and the RTAs have operating leases for office space.

The future minimum rental payments required under operating leases having initial or remaining non-cancelable lease terms in excess of one year are as follows (amounts in thousands):

<u>Years Ending June 30,</u>	Massachusetts Bay Transportation Authority	Massachusetts Turnpike Authority	Water Pollution Abatement Trust	NonMajor Component Units	Total
2002	\$ 13,382	\$ 925	\$ -	\$ 3,317	\$ 17,624
2003	14,071	925	-	3,336	18,332
2004	13,651	1,388	-	1,807	16,846
2005	12,804	-	-	800	13,604
2006	13,370	-	-	459	13,829
2007 - 2011	64,519	-	-	575	65,094
2012 - 2016	19,564	-	-	245	19,809
2017 - 2021	-	-	-	191	191
Total payments	<u>\$ 151,361</u>	<u>\$ 3,238</u>	<u>\$ -</u>	<u>\$ 10,730</u>	<u>\$ 165,329</u>

13. COMMITMENTS

Primary Government –

Governmental Funds - As part of the General Appropriation Act of 2000 (Chapter 127 of the Acts of 1999) the funding mechanism for the net cost of service and other costs of the Massachusetts Bay Transportation Authority (MBTA) was changed. The change was effective July 1, 2000. Under the new funding method (Forward Funding), the MBTA's costs will be funded on a current basis. This method apportions a "dedicated sales tax" amounting to 1% of applicable sales in the Commonwealth, directly to the MBTA. The dedicated sales tax will be equal to the greater of the amount raised by the sales tax or \$645,000,000, (the base revenue,) subject to an adjustment for inflation, capped at 3% annually.

Regional Transit Authorities - Under Chapter 161B of the General Laws, the Commonwealth is obligated to provide annual subsidies to certain regional transit authorities for contract assistance, debt service assistance and their net cost of service deficiencies. The Commonwealth recovers a portion of these payments through assessments to the cities and towns served. During fiscal year 2001, net expenditures were \$16,417,000. In addition, for fiscal year 2001, the

Commonwealth appropriated \$17,232,000 to the regional transit authorities to cover net costs of service for the calendar year ended December 31, 2000.

MBTA and Other Authorities - The Commonwealth continues to guarantee MBTA debt issued prior to June 30, 2000 but no longer provides contract assistance on this debt. The amount of debt issued prior to June 30, 2000 that remains outstanding at June 30, 2001 totaled \$4,095,450,000.

The MBTA's forward funding legislation provides for the MBTA to issue general obligation, revenue or other debt secured by a pledge or conveyance of all or a portion of revenues, receipts or other assets or funds of the MBTA. This new debt is not backed by the full faith and credit of the Commonwealth. Finally, the MBTA will not receive any principal or interest subsidies from the Commonwealth for the repayment of either the prior debt or new debt of the MBTA beyond the pledged revenues.

In addition to the MBTA, the Commonwealth guarantees debt of a number of Public Authorities. At June 30, 2001, the aggregate outstanding debt for which the Commonwealth is obligated to provide contract assistance support totaled approximately \$196,641,000 long-term and \$86,266,000 short-term.

In addition, the Commonwealth guarantees the debt of certain local governments and public higher education building authorities but does not provide contract assistance. The guaranteed long-term debt outstanding at June 30, 2001 was approximately \$395,302,000.

At June 30, 2001, the Commonwealth had commitments of approximately \$1,707,745,000 related to ongoing construction projects. The majority relate to construction funding for the Central Artery/Tunnel Project. The Central Artery/Tunnel Project continues to anticipate federal participation and payments from the Massachusetts Turnpike Authority (MTA) and the Massachusetts Port Authority (MassPort).

On August 9, 2000, the Route 3 North Transportation Improvements Association issued its Commonwealth of Massachusetts Lease Revenue Bonds, Series 2000, in the aggregate principal amount of \$394,305,000, payable from lease payments to be appropriated annually by the Commonwealth through fiscal 2033. The bonds are an indirect obligation of the Commonwealth.

Saltonstall Building - On July 19, 2000, after reviewing proposals received from various development teams to redevelop the Saltonstall State Office Building, the Governor filed legislation that would authorize the Massachusetts Development Finance Agency (MDFA) to undertake the redevelopment. The provisions of the Governor's bill were added to the bond authorization legislation approved August 10, 2000 relating to preservation and management of the Commonwealth's real property assets. Under the provisions relating to the Saltonstall Building, the building is to be leased by the MDFA for a lease term of up to 50 years, with extension terms permitted for an aggregate of 30 more years). The MDFA will renovate the building and lease half of it back to the Commonwealth for office space and related parking (for a comparable lease term). The remainder of the building is to be redeveloped as private office space, as well as private housing units and retail establishments.

Central Artery / Tunnel Project - The Central Artery / Tunnel Project is the largest single component of the Commonwealth's capital program according to

the finance plan filed as of October 1, 2001. The current cost estimate is \$14.475 billion, an increase of \$400,000,000 from the October 1, 2000 plan. The largest components of the increase were added costs of construction and the addition of a project contingency budget. Both plans include a maximum obligation of \$8.549 billion from the federal government. Project milestones have been reviewed to include a nine-month extension to the I-90 opening and a four-month extension to the I-93 opening. The I-90 opening may be delayed further due to a major leak in the Fort Point Channel Tunnel discovered in October 2001. The finance plan is currently under review.

To make up for the \$400,000,000 in needed funds, the Governor immediately filed a bill to raise the bonding authority for the project in place under Chapter 87 of the Acts of 2000 from \$1.350 billion to \$1.5 billion. An additional \$175,000,000 is expected to come from \$50,000,000 in interest earnings and \$125,000,000 in bond capacity generated from higher than expected license and registration renewal fees. Both of these amounts will be reported within the Central Artery Statewide Road and Bridge Infrastructure Fund.

In connection with the Central Artery / Tunnel Project, on May 8, 2000, the State Treasurer's office was advised that the staff of the Securities and Exchange Commission (SEC) is conducting a formal investigation in the matter of "Certain Municipal Securities/Massachusetts Central Artery (B-1610.0)." This is pursuant to a formal order of private investigation issued by the SEC. The attorneys on behalf of the Commonwealth believe that the likelihood of loss by the Commonwealth is remote.

During fiscal year 2001, the Commonwealth received payments from MTA and MassPort pursuant to three separate memoranda of understandings dated September 12, 1997 and August 13, 1998 and February 19, 1999 respectively. The MTA and MassPort made payments to the Commonwealth to finance portion of the Central Artery/Tunnel Project in the amount of \$200,000,000 and \$65,000,000 respectively. The payments totaling \$200,000,000 in fiscal year 2001 from MTA are presented as a "Transfer in Component Units" in the Capital Projects Fund. An additional \$4,000,000 is being held in escrow, pending an eminent domain settlement.

All payments pursuant to the agreements have been made from the MTA, except for the \$4,000,000 noted above. MassPort is due to make payments for the project under the agreements from fiscal 2003 through 2005 in the amounts of \$104,000,000, \$50,000,000 and \$51,000,000 in those respective fiscal years.

Pension (and other employee benefit) Trust Funds – At June 30, 2001, PRIT had outstanding commitments to invest approximately \$437,165,000 in real estate, and approximately \$1,750,215,000 in alternative investments. The fair value of the proposed investment commitments approximates their stated value.

PRIT regularly trades financial instruments with off-balance sheet risk in the normal course of its investing activities to assist in managing exposure to market risks such as interest rates. These financial instruments include forward foreign currency exchange contracts and financial futures contracts.

PRIT may enter into "TBA" (to be announced) purchase or sale commitments to purchase or sell mortgage backed securities. The risk of loss is in addition to the risk of decline in the value of PRIT's other assets. See PRIT footnotes to financial statements for more detail.

Discretely Presented Component Units -

Chapter 152 of the Acts of 1997 provides \$609,400,000 for the construction of a Convention and Exhibition Center that will provide 600,000 square feet of exhibit space at a site in South Boston. The Boston Redevelopment Authority (BRA) is authorized and directed by the legislation to acquire the land, properties, and rights related to the proposed construction site. Once this is accomplished, the Massachusetts Convention Center Authority (MCCA) will oversee construction of the new facility. The MCCA will operate the new center, along with the Hynes Convention Center, the Boston Common Garage, and the Springfield Civic Center.

As of June 30, 2001, the Massachusetts Water Pollution Abatement Trust (MWPAT) has agreed to provide loans of \$248,700,000 to various local government units to be funded with grant awards.

Massachusetts Housing Partnership Fund (MHP) has executed twenty-three loan agreements with ten banks totaling approximately \$440,932,000 pursuant to the Massachusetts Nationwide Interstate Banking and Community Reinvestment Act. Related to that, MHP has funding commitments outstanding for funds not yet advanced of approximately \$45,528,000 at June 30, 2001.

The MTA entered into construction contracts for the Metropolitan Highway system and the Western Turnpike with various construction and engineering companies. Construction contracts outstanding at December 31, 2000 approximated \$21,400,000. Projected construction expenses for calendar 2001 approximate \$71,800,000.

14. CONTINGENCIES***Primary Government -***

Governmental Funds – The General Fund services claims for all risks of loss for which the Commonwealth is exposed, other than workers' compensation and employee group health and life insurance, which are managed in its Internal Service Funds. A number of lawsuits are pending or threatened against the Commonwealth which arose from the ordinary course of operations. These include claims for property damage and personal injury, breaches of contract, condemnation proceedings and other alleged violations of law. For cases in which it is probable that a loss will be incurred and the amount of the potential judgment can be reasonably estimated, or a settlement or judgment has been reached but not paid, the Attorney General estimates the liability to be approximately \$27,000,000 as of June 30, 2001. The General Fund allocates the cost of providing claims servicing and claims payment by charging a premium to each fund based on claims paid during the year.

The Commonwealth receives significant financial assistance from the federal government. Entitlement to these resources is generally conditional upon compliance with terms and conditions of the grant or reimbursement agreements and with applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all federal financial assistance is subject to financial and compliance audits. Any disallowances become liabilities of the fund that received the assistance. As of June 30, 2001, the Commonwealth estimates that liabilities, if any, which may result from such audits are not material.

The Commonwealth's abandoned property law requires deposit of certain unclaimed assets into a managed Fiduciary Fund. These unclaimed assets, less \$4,925,000 that is expected to be reclaimed and paid in fiscal year 2002, are to be remitted to the General Fund each June 30, where it is included as a transfer. Amounts remitted during fiscal year 2001 totaled approximately \$86,585,000. Since inception, approximately \$968,607,000 has been remitted. This represents a contingency, because claims for refunds can be made by the owners of the property.

Tobacco Settlement – A Master Settlement Agreement (MSA) was executed in November of 1998 between five tobacco companies and 46 states, including the Commonwealth. The MSA called for, among other things, annual payments to the states in perpetuity. These payments have been estimated to total more than \$200 billion over the first 25 years, subject to various offsets, reductions, and adjustments. In fiscal year 2001, the Commonwealth received approximately \$242,470,000 or 87% of the estimated amounts shown in the agreement. Of that amount approximately \$81,506,000 was transferred to the Tobacco Settlement Fund, a governmental fund. The majority of expenditures from the fund this year were for Health and Human Services, Elder Affairs and Medicaid costs. The remaining receipts from fiscal 2001 are held for future use.

The amounts that might be payable, if any, by the Commonwealth for legal costs relating to the tobacco litigation cannot be determined at this time. The outside attorneys for the Commonwealth were awarded approximately \$775,000,000 in fees to be paid over time by the tobacco companies and, therefore, were not to be paid out of the Commonwealth's award. The outside attorneys have notified the Attorney General that they reserve their right to submit a claim to the Commonwealth for the difference between the \$775,000,000 and 25 percent of the Commonwealth's settlement payments.

Internal Service Fund - It is the policy of the Commonwealth to manage its risks internally and self-insure for claim settlements for risk of loss relating to workers' compensation for the state employees and group health insurance in its Internal Service Fund. The Internal Service Fund allocates the cost of providing claims servicing and claims payment by charging a premium to each fund based on actual claims paid during the year. All risk financing liabilities are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Liabilities include amounts for claims that have been incurred but not reported. Claims liabilities are reevaluated periodically to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

Employees Workers' Compensation and Group Health Insurance costs for Commonwealth employees are recognized when losses are incurred. The Commonwealth's outstanding liability for such losses at June 30, 2001, including claims incurred but not reported, is estimated to be \$294,249,000.

Central Artery/Tunnel Project – Owner Controlled Insurance Program (OCIP) - The Commonwealth has assumed responsibility for providing workers' compensation and general liability insurance coverage for all contractors and subcontractors working on the Central Artery/Tunnel Project by implementing OCIP. As part of its initial financial planning, Project management determined that an OCIP could provide necessary insurance coverage at a substantially lower aggregate cost than could be obtained if each contractor purchased coverage separately, because of economies of scale in the purchase of coverage from a single carrier, elimination of cross claims among

contractors, and implementation of a cost-effective safety and loss control program for the entire Project. The OCIP is presently structured as a retrospectively rated insurance program with loss retention (or deductible) levels of \$1,000,000 per claim, \$3,000,000 per occurrence for workers compensation and \$2,000,000 per claim, \$6,000,000 per occurrence for general liability coverage. The Commonwealth is responsible for loss costs up to these deductible levels.

As part of the OCIP, the Project has agreed to establish and fund a Trust, held by an independent third party Trustee, in an amount necessary to cover the Project's potential cumulative liabilities to the carrier for these loss costs, administrative expenses and certain defined contingencies under the OCIP. The OCIP is expected to cover such costs through the construction period and through the period after the construction during which all claims will be resolved and paid, referred to as the "tail period".

The amounts payable for workers' compensation coverage are based on standard premium at rates approved by the Insurance Commissioner. General liability premiums are based on negotiated rates and are paid directly to the insurance carrier, which holds the premium for three years, after which time, amounts may be transferred to (or from) the Trust based on loss experience for that year. In addition, the Trust earns investment income, part of which is paid to the carrier as part of its compensation and the remainder is credited to the Project and held in the Trust to cover the Project's cumulative obligations. The amounts in the Trust are restricted by its terms and cannot be used for other purposes. Any amounts which remain in the Trust after all losses and other obligations of the Project are paid, will be re-paid to the Project for distribution in accordance with funding agreements with the federal government. During fiscal year 2001, \$50,000,000 was transferred to the project.

The Project's OCIP activity is reported as an Internal Service Fund. The "Claims and Judgements liabilities" reported therein represents the Project's liabilities as estimated an independent actuary for incurred losses as of the end of the fiscal year. The Internal Service Fund also includes amounts set aside in the Trust to cover the Project's cumulative workers' compensation loss, its general liability loss and premium obligations along with certain other expenses, from the inception of the OCIP (1992) through the end of the tail period.

The estimated Claims and Judgements liability for occurrences through June 30, 2001 is \$83,400,000. This amount is based on the results of a review performed by an independent actuarial firm retained by the Project, and it represents an estimate of liabilities incurred based on past experience for claims reported and not reported as of June 30, 2001. This estimate does not reflect the maximum potential obligation of the Project under the terms of the OCIP agreement.

For a period of time prior to the finalization of the amended and restated agreements related to the OCIP, portion of the premiums for comprehensive general liability coverage were placed in a segregated account held by a custodian. The amount reflected as premiums in the financial statements with respect to the OCIP represents the amount transferred to the Trust from that segregated account.

The United States Department of Justice has notified the Project that it is conducting an investigation of the OCIP. The United States Department of Transportation ("US DOT") Inspector General's Office is also conducting an on-going audit of the Plan. The Project intends to update its October 3, 2000

report to the Federal Highway Administration (FHWA) and anticipates making a recommendation over the appropriate level of funding in the OCIP Trust. Management does not expect that the results of these investigations will have a material effect on the financial statements of the Commonwealth.

Claims and Judgements - Changes in the balance of claims and judgements liabilities for the primary government during fiscal 2001 were as follows (amounts in thousands):

	SHORT TERM	LONG TERM	TOTAL
Liability, Beginning of Year	414,437	134,800	549,237
Current Year Claims and Changes in Estimates	918,278	21,800	940,078
Claims Payments	(928,066)	(43,600)	(971,666)
Liability, End of Year	<u>404,649</u>	<u>113,000</u>	<u>517,649</u>

The following amounts were recognized in the following funds as of June 30,

	SHORT TERM	LONG TERM	TOTAL
Claims and Judgements Liability as of 6/30/2001			
General Fund	\$ 27,000	\$ -	\$ 27,000
General Long-Term Debt Account Group		113,000	113,000
Internal Service Funds	377,649		377,649
TOTAL	<u>\$ 404,649</u>	<u>\$ 113,000</u>	<u>\$ 517,649</u>

2001 related to the liability for Claims and Judgements:

Discretely Presented Component Units - The MBTA reserves self-insurance liabilities as claims and judgements as of June 30, 2001. Changes in the self-insurance reserves in fiscal 2001 and 2000 were as follows (amounts in thousands)

	2001	2000
Liability, beginning of year.....	\$60,846	\$ 73,218
Current year claims and changes in estimates.....	90,958	69,973
Claims payments.....	<u>(82,328)</u>	<u>(82,345)</u>
Liability, end of year.....	<u>\$ 69,476</u>	<u>\$ 60,846</u>

Other Contingencies - The Massachusetts Turnpike Authority has obtained health coverage for most employees through various commercial health maintenance organizations. The health coverage for certain other employees, as well as coverage for job-related injuries to all employees, is self-insured by the Authority, with risks managed internally. At December 31, 2000, the accrual for outstanding claims under these programs, including claims incurred but not reported, was approximately \$9,000,000.

Business Type Activities - University of Massachusetts - During fiscal year 1998, UMass Memorial Health Care, Inc., (UMass Memorial) a non-related party was created to merge all of the subsidiaries to the UMass Health System. In connection with this merger, the University of Massachusetts and UMass Memorial have entered into the following agreements:

UMass Memorial is granted the right to occupy portions of the UMass campus for a period of 99 years and UMass Memorial agrees to share responsibility for various capital and operating expenses relating to the occupied premises. UMass Memorial also agreed to contribute to capital improvements to shared facilities.

UMass Memorial agrees to make certain payments to UMass and its related organizations, including: 1) an annual fee of \$12,000,000 (plus an inflation adjustment), for 99 years as long as UMass continues to operate a medical school; 2) a percent of net operating income of UMass Memorial based upon an agreed-upon formula; and 3) a \$31,500,000 contribution plus interest by UMass Memorial to jointly fund and develop a new research facility with UMass. This contribution was made during fiscal year 2001. UMass will own and control the research facility.

UMass will lease certain employees to UMass Memorial or its affiliates during a transition period ending 2008.

Certain academic funds (net assets) held by the Clinical Division as of March 31, 1998 (Departmental Education Funds) will remain assets of UMass and will be held by UMass Memorial for UMass and allocated to each academic department.

UMass is reimbursed by, and reimburses, UMass Memorial for certain services provided and purchased. For the fiscal year ended June 30, 2001, the revenues for services provided to UMass Memorial were \$98,600,000. At June 30, 2001, UMass has recorded a receivable in the amount of \$34,900,000 from UMass Memorial for costs related to shared services, leased employees, and other agreed-upon payments due to UMass. UMass has recorded a payable at June 30, 2001 of \$6,400,000 for amounts due to UMass Memorial for shared services and other agreed-upon payments due to UMass Memorial.

15. SUBSEQUENT EVENTS

Prior to the events of September 11, 2001, the national and local economies had been weakening, reflecting lower business investment, increased unemployment and, recently, a decline in consumer confidence. Reduced economic activity is expected to lower corporate profits, increase job losses and reduce consumer spending, which would result in reduced personal income and sales tax receipts and other tax revenues for the Commonwealth. The events of September 11 increased the risk of a possible recession and a delay in recovery.

On December 5, 2001, the Commonwealth passed its FY02 General Appropriation Act retroactive to July 1, 2001. Previous to its passage, the Commonwealth had been operating on interim spending authorizations. The General Appropriation Act anticipates total budgeted expenditures at \$22.3 billion for the fiscal year.